SOCIAL SECURITY FINANCING PROPOSALS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-FIFTH CONGRESS

FIRST SESSION

JUNE 13, 16, 23, AND 24, AND JULY 15, 1977

Printed for the use of the Committee on Finance

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SOCIAL SECURITY FINANCING PROPOSALS

MONDAY, JUNE 13, 1977

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY,
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:35 a.m. in room 2221, Dirksen Senate Office Building, Hon. Gaylord Nelson (chairman of the subcommittee) presiding.

Present: Senators Long, Byrd, Jr., of Virginia, Nelson, Hathaway, Curtis, Dole, Laxalt, and Danforth.

[The committee press release announcing these hearings follows:]

[Press Release]

FINANCE SUBCOMMITTEE ON SOCIAL SECURITY SETS HEARINGS ON SOCIAL SECURITY FINANCING PROPOSALS

The Honorable Gaylord Nelson (D., Wis.), Chairman of the Subcommittee on Social Security of the Committee on Finance, announced today that the Subcommittee plans to hold hearings on proposals for maintaining the financial soundness of the Social Security program.

Senator Nelson stated that the Honorable Joseph A. Califano, Jr., Secretary of Health, Education, and Welfare, will be the leadoff witness on June 13. Secretary Califano will present testimony concerning the actuarial status of the social security trust funds and the Administration's proposals for legislation to improve their financial integrity.

The hearings will begin at 10:00 a.m. on Monday, June 13, 1977, in Room 2221, Dirksen Senate Office Building.

Nelson said, "The social security system directly affects the lives of most Americans. Some 33 million receive monthly compensation from the social security trust funds and over 100 million persons presently are contributing to the system. It is absolutely essential that the financial soundness of the social security trust funds be restored to assure present and future beneficiaries of the economic security they expect and deserve."

President Carter sent a legislative package to Congress on May 9, 1977, to deal with both short and long range social security financing problems. These proposals included:

Instituting a special counter-cyclical system of financing from general revenues which would replace the social security taxes that are lost when the unemployment rate exceeds 6 percent.

Removing the ceiling on the amount of an individual's wage or salary on which the employer pays social security taxes.

Restorng the basic (Old Age, Survivors and Disability Insurance) (OASDI) social security tax that is paid by the self-employed to the traditional rate of 1½ times the tax on employees.

Making some shifts of funds among the different social security trust funds.

Imposing increases in the amount of wage or salary on which an employee must pay social security tax. The increase would be $600 in each of four future years—1979, 1981, 1983 and 1985.

Changing the test of whether an individual may claim social security benefits as a dependent, in conformity with Supreme Court decisions requiring men and women to be treated equally.

Correcting the excessive adjustment for inflation which was applied to future social security benefits.

Advancing to 1985 one-quarter of the 1 percent increase in the OASDI tax that is currently scheduled to go into effect in 2011 and advancing the remaining three-quarters percent to 1990.

Other hearings on social security financing are scheduled for June 16, 23 and 24 and July 15. The witnesses for these hearings are as follows:

June 16

Wilbur Cohen, Former Secretary of Health, Education, and Welfare, Dean, School of Education, University of Michigan

Robert Ball, Former Commissioner of Social Security

Rita Ricardo Campbell, Senior Fellow, Hoover Institution on War, Revolution and Peace, Stanford University, and former member, Social Security Advisory Council

June 23

Representatives of the following organizations:

American Federation of Labor and Congress of Industrial Organizations

Chamber of Commerce—National Association of Manufacturers Business Roundtable

United Automobile, Aerospace, and Agricultural Implement Workers of America

National Federation of Independent Businessmen

June 24

William Hsiao, Consultant, Professor of Economics, Harvard University

Robert Myers, Consultant, Former Chief Actuary, Social Security Administration

Otto Eckstein, President, Data Resources, Inc. and Professor of Economics, Harvard University

July 15

Representatives of the following organizations:

National Council of Senior Citizens

American Association of Retired Persons—National Retired Teachers Association

National Small Business Association

American Council of Life Insurance

Written Statements.—Witnesses who are not schseduled for oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearings. These written statements should be submitted to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, not later than July 20, 1977.

Senator Nelson. The Senate Finance Subcommittee on Social Security today begins hearings on proposals to restore the financial status of the social security trust funds.

At the present time, the social security trust funds are not in balance. Expenditures from the social security trust funds are outpacing income to them.

This imbalance jeopardizes the financial integrity of the social security system, and it has caused much skepticism among workers contributing payroll taxes to the system about whether they and their families can depend upon social security benefits when they retire, if they should become disabled, or should die leaving dependents.

In fact, there are two cash benefits deficits: a short-term deficit caused by recent economic conditions—excessive unemployment and

high inflation—and a long-term deficit resulting from changing economic and demographic assumptions used for the actuarial estimates.

According to the 1977 social security trustees report, the funds supporting the old-age and survivors insurance program will be depleted by 1983, and the disability insurance funds will be exhausted by 1979. Expressed another way, the Administration has stated that at least $83 billion in additional funds are needed by 1982 to maintain the present social security program on an actuarially sound basis. These immediate financial shortfalls are compounded by the projected long-term deficits.

In the 75-year period ending in 2051, the long-run average deficit for the cash benefits programs is estimated at 8.2 percent of the taxable payroll. This is equivalent to $66 billion per year if based on 1977 constant dollars.

Dealing with these deficits is no easy task. Ultimately it means reducing current benefits, increasing taxes, or combining these two approaches. But no matter what financing mechanism is used to compensate for the social security deficits, any proposal or set of proposals which impose new taxes or decrease benefits will inevitably be extremely controversial.

Nevertheless, the social security trust funds cannot be allowed to go bankrupt. At stake is the stability of one of this country's most important and enduring institutions. The economic and social well being of the American people hangs in the balance.

That is why action during the 95th Congress is so important. Congress has a legal and moral responsibility to the American people to insure that social security benefits are available to them when they expect and deserve protection from earnings losses or from the high costs of being hospitalized.

On May 9, 1977, the administration announced a full-scale program to deal with both immediate and longer term social security financing problems.

Of the various proposals made by the Carter administration, two of them are of particular significance: using general revenues to help finance the social security trust funds during periods of excessive unemployment and removing the ceiling on the amount of an individual's wage or salary on which the employer pays social security taxes. These two proposals, more so than any of the others, would establish landmarks in the social security law if adopted by Congress.

Until this time, general revenues have not generally been used to finance the social security cash benefits programs, nor the hospital insurance program. And the wage base upon which employers pay social security payroll taxes thus far has been equal to the wage base upon which workers contribute their share of the payroll tax. The administration's financing proposals would modify the traditional method of financing the social security benefits programs. These proposals, as well as the others submitted by President Carter, will be closely examined during the course of these hearings.

One thing is very certain. Before any new taxes are imposed to pay for fiscal shortfalls or to maintain current benefits, it is vitally important for Congress and this subcommittee to consider every viable option and to ascertain the economic and social benefits and costs of

these new financing mechanisms. The subcommittee will be especially interested in identifying sectors of the population which will bear the burden of any new social security taxes and the effects of such new taxes upon them, as well as upon the economy in general.

Finally, it should be noted that the status of the social security system has been the subject of a great deal of debate over the past few years. Some people have questioned the effectiveness of the social security programs in satisfying the needs of our population, while others have concentrated on both the immediate and long-term financial problems of maintaining the programs now in effect. But these two issues cannot be discussed alone, one without the other, because each is a crucial part of the problem as well as the solution. A discussion of financing social security trust funds is inextricably linked to a discussion of the adequacy and amount of benefits to be provided.

Senator Laxalt.

Senator Laxalt. Mr. Chairman, I am delighted to be here this morning to do what I can to assist in finding a solution to what has to be one of the most pressing social problems of our time. In virtually every advanced industrial country mounting social security deficits are posing profound social, political, and economic problems. Although the United States was one of the last industrial countries to establish a social insurance structure, I would like to see our country become the first in the world to solve its financing problems. Hopefully, these hearings will assist us in formulating financing solutions which will not only restore our own system to a firmer footing but also provide a model for other countries facing similar difficulties.

As the chairman has noted, our emphasis today and in subsequent meetings is to be strictly focused on financing. Although not politically expedient, I believe this to be both necessary and commendable. The need, particularly in the disability and OASI trust funds, is obvious: Trustees predict that they will face exhaustion by 1979 and 1983 respectively.

Yet, perhaps less obvious is the fact that just facing the problem will be good politics. True, almost nothing can be done to raise additional funds without making someone worse off. But I have long felt that the American people genuinely want to have their representatives deal with difficult problems in a responsible way.

Of course, as of yet we have no specific legislation before us. What is more, if the rough treatment recently received by the administration's proposals in the Ways and Means Committee is any indication, it will probably be some time before we have any legislation. Even so, the Carter package is likely to constitute a bench mark, or perhaps more accurately, a lightning rod during these proceedings and I would like to venture several observations of my own at this time.

(1) Decoupling is essential. There are few things in social security on which there is anything approaching universal agreement. One of these is the over indexing technical error made by the 1972 Social Security Act Amendments. Replacement ratios made sensitive to increases in both wages and prices by that act will soon be completely out of whack.

Certainly our retirees need to be protected from the ravages of inflation and the intent of the 1972 amendments was to do precisely that. However, we must separate the indexation of the benefit schedule from the positive at which future retirees will enter that schedule. I am looking forward to the experts' discussion of the comparative merits of the relative wage approach vs. the real wage approach to help shed some light on the most effective means for accomplishing this.

(2) General revenue financing is wrong. The social security trust funds are just moving into deficit. The Treasury has been there for a long time. Although my good friend, Congressman Bill Archer, described the proposal for general revenue financing in the Ways and Means Committee as the blind leading the blind, I think general revenue financing for social security is more a case of adding fuel to the fire—the fire of ever greater Federal deficits.

Also, although social security is not in a strictly technical sense an insurance program, social security recipients and their employers have contributed substantial sums toward their retirement. They are entitled to the benefits they receive irrespective of their overall financial condition. To use general revenue funding is to ignore this contribution aspect. With taxpayers' moneys being expended, it is logical to assume that they should be allocated on the basis of need. Once this happens, social security becomes indistinguishable from AFDC or any other welfare program. Personally, I cannot accept any diminution of the earned right principle.

(3) The wage base for employers should not be removed. We need to encourage the creation of high wage, productive jobs rather than discourage it. And the last thing we need is to stimulate another round of inflation. Yet, the proposal to remove the wage base on employers succeeds in both discouraging job creation and sparking inflation. The Secretary may really believe that employers will absorb the additional $30 billion out of profits and furthermore that businesses will not be deterred from creating high wage jobs by the additional costs involved. But I don't. I see the removal of the employers' wage base as costly for consumers and workers alike.

(4) The reserve level should not be lowered. The present 50 percent level is already inadequate to assuage public concern about the financial integrity of the system. Although the administration argues that with the Treasury backing inherent in general revenue financing, the reserve level can safely be reduced to 33 percent, I see this as merely adding to the public perception of social security as a financial house of cards. I am even more concerned that in the event general revenue financing is denied, the administration will still seek to reduce the reserve level.

CONCLUSION

Quite obviously I am unhappy with a good portion of the Carter package. I certainly commend the President for confronting a difficult problem. But I believe we need to do better. Perhaps Chairman Ullman is right and we need a whole new approach to social security

financing. Without question we have overloaded the payroll tax with backbreaking consequences.

Where to from here? Frankly, I am not sure. I sense a need for innovative new initiatives, but I am uncertain as to precisely what they should be. Consequently, I am eagerly looking forward to these proceedings in the hope that they will assist us in finding responsible answers to some very difficult questions. Thank you.

Senator NELSON. The subcommittee is pleased to welcome Secretary of Health, Education, and Welfare Joseph Califano, Under Secretary of Health, Education, and Welfare Hale Champion, and the Commissioner of Social Security Bruce Cardwell before the panel today. Your testimony and comments will be an important part of these hearings. You may proceed however you so desire.

STATEMENT OF HON. JOSEPH A. CALIFANO, JR., SECRETARY, DEPARTMENT OF HEALTH, EDUCATION AND WELFARE, ACCOMPANIED BY JAMES BRUCE CARDWELL, COMMISSIONER, SOCIAL SECURITY ADMINISTRATION

Secretary CALIFANO. Mr. Chairman, I would like to submit my statement for the record. If I may just go to those charts over there and summarize it through these charts—each member of the subcommittee, I believe, has charts.

I would like to initially note, I bring you a message from the President; I just left a Cabinet meeting. He wanted to first express his appreciation to you, Mr. Chairman, and to the subcommittee for hearing our proposals on this subject so promptly; and secondly, to note that next to the energy program, he considers this the most urgent piece of business before the Congress because of the tremendous concern of older Americans about the viability and integrity of the trust funds.

Senator NELSON. Would you please identify your associate?

Secretary CALIFANO. With me is Mr. Bruce Cardwell, Social Security Commissioner, who will be with me this morning to help me answer any questions.

Mr. Chairman and members of the committee, this is a quick overview of the social security system. We now have, in the basic retirement program, 28,600,000 beneficiaries to whom we will make payments in 1977 of a little over $73 billion.

We have in the disability insurance program 4.8 million beneficiaries to whom we make payments of $11.5 billion.

We have, in the hospital insurance program and supplemental medical insurance program, another 25 million people with benefit protection. About $22 billion in health benefits will be paid in 1977.

Senator NELSON. Do any of your charts go back a number of years and project, year by year, the number of beneficiaries and the payments made under the cash benefits?

Secretary CALIFANO. They do not. That material will have to be provided for the record. These charts do not project that. It has been going up.

[The following was subsequently supplied for the record:]

NUMBER OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE (OASDI) BENEFICIARIES AND AMOUNT OF OASDI BENEFITS PAID, SELECTED YEARS, 1950–75

	Beneficiaries (thousands)	Benefit (millions)
1950	[1] 3,477	[1] $961
1955	[1] 7,961	[1] 4,968
1960	14,845	11,245
1965	20,867	18,311
1970	26,229	31,963
1975	31,122	66,923

[1] OASI only.

Secretary CALIFANO. The principles of social security financing have essentially been pay-as-you-go financing with each year's revenues normally financing that year's benefits and the trust funds serving as contingency reserves. There are four separate trust funds—old age and survivors' insurance, disability insurance, and hospital insurance—which are paid through the earmarked payroll taxes—and the supplementary medical insurance trust fund—which is financed by monthly premiums paid by the beneficiaries and general revenues.

The short-term financing problems we face are that there have been annual deficits in the cash program since 1975. We have been taking in less money in the disability insurance program and the OASI program than we have been paying out. If we do not move to correct it, the disability insurance trust fund will be absolutely depleted within about over 2 years. The old-age survivors' insurance trust fund will go broke by 1983, within 5 or 6 years. We need additional revenue in these two funds.

This chart graphically illustrates, in a sense, Mr. Chairman, what has been happening to the reserves and what will be happening, the dramatic decline in the Disability Insurance Trust Fund and the decline in the old-age and survivors insurance trust fund.

Senator HATHAWAY. The previous chart talks about sound reserve. What do you mean?

Secretary CALIFANO. With our plan, Senator Hathaway, if you protect for severe economic recession, that is, unemployment above 6 percent, then 35 percent is a sound reserve level which our plan provides. If you do not do that, we think the reserve should be at least 50 percent. When I say we, I am reporting what the professional actuaries of the social security system are saying.

Senator HATHAWAY. Is that 50 percent of the annual payout?

Secretary CALIFANO. Yes.

Senator NELSON. You project 35 percent to be sound, if the general fund is used for purposes of meeting deficits that occur where unemployment is more than 6 percent?

Secretary CALIFANO. That is correct, Mr. Chairman. If general revenues are available. That 15 percent difference is, we believe, sound with the use of general revenues to cover severe unemployment.

Our objective was to put together a plan to submit to the Congress that would avoid increases on tax rates to employees. The commitments the President made during the campaign were to not impair the economic recovery; to eliminate annual deficits beginning in 1978; to help reduce the long-term deficit; and to have adequate trust fund re-

serves—35 percent level under our proposal by 1982. This plan fulfills the President's pledges to the American people.

These are short-term needs. The old-age survivors' disability insurance and hospital insurance trust funds needs above current revenues, above revenues from 1977 tax rates, $117 billion.

Senator CURTIS. Over how long a period of time?

Secretary CALIFANO. Five years. The 1978–82 period.

Senator CURTIS. You need about $23 billion a year?

Secretary CALIFANO. That is about right, yes, sir. There is presently scheduled in the law the hospital insurance tax rate increase to go into effect in 1978 and 1981. They will provide $34 billion without any action. That leaves a need for $83 billion during this 5-year period.

We have looked at several ways of doing this. We looked at ways in which you can juggle the money in the existing trust funds and try to hang on through a couple of more years. We considered that to be playing Russian roulette, and rejected it.

There are tax rate increases that we believe produce inadequate reserves and the conventional plan that would provide adequate reserves by equally taxing employees and employers. We can describe this in any number of ways.

For the record, the tax rate increases we believe would provide inadequate reserves are two. One is the proposal that was made in the Ford administration that would have taxed employees and employers an additional 0.55 percent each. We believe that that fund would not provide a trust fund viability level of 50 percent by the end of this 5-year period. It would leave the funds at about 30 percent and that we believe would be actuarially unsound.

The alternative plan that has been proposed by several to this committee, and on which you will be hearing testimony from the National Association of Manufacturers, is to provide a tax increase of 0.3 percent. That, we believe, is even more severely inadequate than the other one. We think more funds are needed.

In 1983, we would be at 30 percent, as I indicated, under the Ford administration plan. We would be all the way down to 18 percent under the NAM alternative.

In the recession we have been through in 1975, 1976 and 1977, the trust funds would have been depleted in 48 months if there had been only 30 percent reserves and depleted in 36 months with 18 percent reserves.

Senator CURTIS. Does that allude to the figures that you came up with that the recession of 1978, 1980, caused social security to suffer a loss of $14.1 billion?

Secretary CALIFANO. I am not sure, Senator, what you are referring to.

Senator CURTIS. The unemployment rate from 1975 to 1978, I understand your statement to say that that caused a loss of revenue to the social security fund of $14.1 billion.

Secretary CALIFANO. That is correct. If you wait until I get to the chart, I will lay it out.

Senator CURTIS. Those figures are very much subject to a challenge.

Secretary CALIFANO. The conventional plan to provide what we consider to be adequate reserves would provide any combination of increase of tax rates and wage rates equally on employer or em-

ployee, to produce this effect. It will take $38 billion from our economy, more than the Carter proposal would take out of the economy. That, I might add, is nearly twice as much the amount of money that Congress just put in, the $20.1 billion, in the stimulus package, although the figures are not directly comparable. This is a 5-year period.

It would increase taxes on employees by $31 billion, more than the administration plan would over this 5-year period. It would increase taxes on employers by $4 billion more than the administration plan. It would increase taxes on the self-employed of our nation by $3 billion more than the administration plan.

Senator Curtis. Would you tell us what you mean by "conventional plan."

Secretary Califano. Any combination of increases in the tax rate and/or the wage base that is distributed equally between employer and employee, with no dip into general revenues or countercyclical financing of the kind that we propose.

Senator Curtis. In other words, if you maintain what you have in the earlier chart, a pay-as-you-go basis, it would call for increases of taxes set forth under your heading of "conventional fund"?

Secretary Califano. If you do it that way on a pay-as-you-go basis, we believe we are also doing it on a pay-as-you-go basis with our plan. If you did it conventionally, equally distributing tax and/or wage base increases between employer and employer, it would cost you that much money.

Senator Curtis. Are you designating your plan as the unconventional plan?

Secretary Califano. I am designating our plan as a plan that is designed to bring the social security system soundly into the next century in a way that does not wallop the low income wage earner.

Senator Nelson. If I may ask a question on that, I understand you to say that if you increase the taxes in the conventional way on both the employer and employee, it would cost the employers $4 billion more a year than the administration proposal which would not increase the taxes on the employee, but rather would take the ceiling off the income that will be taxed on an employee's salary. Is that correct?

Secretary Califano. By the employer.

Senator Nelson. By the employer?

Secretary Califano. That is correct.

Senator Nelson. That $4 billion is achieved by projecting an increase in the taxes against salary over a period of time without taking the limit off both sides?

Secretary Califano. That is correct.

Senator Nelson. I notice that in your statement you make reference to the fact that taking the ceiling off the taxes paid by the employer on employees' salaries does not affect significantly the taxes paid by the small businesses?

Secretary Califano. That is correct, Mr. Chairman. I was going to mention that after I had finished here; you are absolutely correct.

The fact is, more than 87 percent of the wage base of this nation is already subject to social security taxes. When we talk about lifting the wage base for the employer to pay a tax on the entire wage base we are simply picking up that last 13 percent. Second, most small

businesses, the grocers, the dry cleaners, the local clothing stores, the local gift shops, the local general stores, do not have any employees who are being paid more than $16,500. They are already paying, the truly small businesses in this country, taxes on 100 percent of the wage base of themselves and their employees. The larger businesses which have high-priced corporate executives are the businesses who are not paying on 100 percent of their wage base.

Senator CURTIS. Just how much money how much of a dollar increase would it cost if a business had the $40,000 employee? What social security tax is he paying this current year in dollars and how much would he have to pay under your proposal?

Secretary CALIFANO. I cannot figure that out in my head. By the time I get back to my seat, I am sure that we can give you an answer.

Senator Curtis. It is much more than double. He is paying on $16,000 now. Now, if you apply the same rate to $40,000, you double the tax.

Secretary CALIFANO. You are right on a very important issue, Senator. Employers who have high-priced payrolls—are not the truly small business in this country.

Senator CURTIS. It includes the Government, of course.

Secretary CALIFANO. The Federal civilian employees are not within the social security system.

Senator CURTIS. I understand that.

Secretary CALIFANO. State and local governments, under our plan, would have an increase, for example, of 2.5 percent in their taxes. Under the conventional plan as proposed, it would increase by almost 10 percent of their taxes. I have a series of figures that I will get to explain this.

Senator LAXALT. Mr. Secretary, in table 38 of the material that has been supplied to us there is an indication that under your plan the percentage increase in employer tax liabilities would be $13.9 for all firms. There is an indication—in fact there is a statement—that is, to small firms, the percentage increase would be 14 percent, and it is the large firms, 14.7.

How do we reconcile this with your statement to the effect that small firms are not going to be penalized?

Secretary CALIFANO. There are a variety of small firms, Senator. I do not have the figures that you have in front of you.

Senator LAXALT. Table 38, Mr. Secretary.

Secretary CALIFANO. I do not have that.

Senator LAXALT. Under the classification, "small firms are those with fewer than 1,050 employees," you made reference to the very small business firm. I do not know what categorization you had in mind.

Secretary CALIFANO. Using that definition small firms would do only slightly better under our plan than the conventional alternative. We estimated that 1981 tax liability would be .09 percent higher under the administration law and 14.1 percent higher than present law under the conventional alternative. They pay more if you use the traditional alternative. We have a list of firms and industry who fare much better under our plan than they do under the plan.

Senator LAXALT. How do they break out in terms of size?

Secretary CALIFANO. When you say small firm you are talking about a definition of small business by numbers of employees which includes

large numbers of employees. For 11 out of 15 industry categories, the tax increase under our plan is less than the tax increase under the conventional alternative. Firms in these 11 industries account for 84 percent of all employment in small firms, in the traditional, legal definition of that term.

Senator LAXALT. How big are they in terms of staffing levels?

Secretary CALIFANO. I don't remember the number. Bruce?

Mr. CARDWELL. All of our data about small business are based on firms of 1,000 employees or less. The Secretary, though, was isolating, in his original discussion, those firms that we know to be very small—small shops.

Senator LAXALT. What percentage of the work force would they constitute?

Secretary CALIFANO. In the small firms, in the small business definition of 1,000 or less, 84 percent—let me put it this way, the 11 categories of industry that do better, that pay less taxes under our proposal than they would under conventional plans, employ 84 percent of the people that are employed in all small firms, 1,000 or less.

Senator LAXALT. According to the chart they are going to pay on the same level as the larger firms.

Secretary CALIFANO. Not in those 11 categories. Let me give you some examples. In agriculture, forestry and fisheries, under President Carter's plan, there will be an increase of tax liabilities for smaller firms of 4.8 percent. Under the conventional plan, the increase would be 11.5 percent. In hospitals and nursing homes, which we are very sensitive about because we are trying to drive the costs down, the increase under the administration plan would be 2.7 percent; under the conventional plan, 10 percent. In educational institutions, the increase under the administration plan would be 6.2 percent; the increase under a conventional plan would be 12.5 percent. In State and local government the increase under the administration plan would be 2.5 percent; under the conventional plan, 10.5 percent. In construction, under our plan, the increase would be 13.7 percent. Under a conventional plan it would be 16.5 percent.

This chart demonstrates how we propose to raise the $83 billion over the 5-year period of 1978–82. We propose that, whenever the unemployment in the Nation exceeds 6 percent per year, for that year the general revenues provide to the social security trust funds the amount of money that would have been raised through social security taxes had the unemployment rate been only 6 percent. So in a year when we have 8 or 9 percent unemployment, the money that is lost on social security taxes for that difference between 6 percent and the actual unemployment rate be provided from the general revenues.

That provision, in terms of history, would have taken effect only 4 years since World War II. There have been only 4 years when unemployment has been so severely high that it has been over 6 percent.

Senator CURTIS. Mr. Secretary, I apologize for interrupting you so many times, but I so terribly disagree with your whole hypothesis on your $14 billion that I feel I must get it into the record at this point.

The social security trustees estimated unemployment for 1978 at 5.2 percent. The actual unemployment was 8.5 percent.

The actual tax loss was $1.8 billion, and for 1976 the trustees estimated 4.9 percent unemployment. The actual unemployment was 7.7 percent and the falloff in social security taxes was 1.7 percent

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Now, that $14 billion, as I understand it, is arrived at by an economic law that is not accepted any place; is about three times too high; and I think that it would be more forthright to take the position that we have been slow to collect the taxes and quick to increase the benefits, and we have a deficit there, rather than try to blame it all on a recession in 1975 and 1976. That accounts for one-third as much as you claim.

Secretary CALIFANO. Mr. Chairman, let me say that we will submit in detail the figures for the record. This $14 billion covers 1975 and 1976 and in 1977 we are still above 6 percent unemployment, and we will not get out of that posture until 1978. I believe these are numbers that were put together by the Social Security Administration experts. I am not blaming all of the shortfall on the recent severe recession of 1975 and 1976. There are a lot of other problems here relating to the social security system that have nothing to do with the recession that we have gone through.

[The following was subsequently supplied for the record:]

UNEMPLOYMENT RATES, 1975–79, AND AMOUNTS OF RESULTING COUNTERCYCLICAL GENERAL REVENUES THAT WOULD BE CREDITED TO THE SOCIAL SECURITY TRUST FUNDS

Year	Unemployment rate (percent)	Payments to be deposited (billions)		
		OASDI	HI	Total
1975	8.5	$4.8	$0.9	$5.7
1976	7.7	3.7	.6	4.2
1977	7.1	2.6	.5	3.1
1978	6.3	.8	.2	1.0
1979	5.8			
Total		11.9	2.2	14.1

Senator LAXALT. Mr. Secretary, you indicated in your testimony to the House that the triggering mechanism would be a rather rare occurrence. You testified to the fact that it happened only four times since World War II.

Secretary CALIFANO. That is correct.

Senator LAXALT. With the present situation we have with the growing work force and looking to the years in the future, is this not going to be just a way of life? Are we not going to build $14 billion or more into the social security program as a permanent thing?

Secretary CALIFANO. I think that it would be a tragedy in this country if unemployment in excess of 6 percent becomes a way of life.

I am sure you do not want it to be a way of life. We are already ahead of our projections in reducing the unemployment rate. I cannot remember what the unemployment rate was for the prior month. We hope to drive it down below 6 percent by the far end of 1978, so I do not think that it will be a way of life. Moreover, I think it is important to note that this provision is proposed for 5 years. There have been many provisions in the social security law that have used general revenues. We need this provision in for 5 years to see how it works. We believe that it will work. This provision gives us more than just the $14 billion. With this provision, there is an insurance policy for the older Americans in this country so that they know that the funds will always be there no matter how bad the economy is. We are also able to move to a trust fund level of 35 percent of what has to be paid out rather than a level of 50 percent. So we save another

$24 billion that we need not raise, and that provision totals $38 billion.

If this provision is not put into the law, then it is our view that the Congress will have to pass tax increases of one kind or the other to raise $38 billion to put it into the social security system. We believe that that is unnecessary.

Another $30 billion, as I indicated, would be raised by taxing the employer on the full earnings of the employee. We would raise $4 billion by increasing the employee earnings base in 1979 and 1981 by $600 each year. We would raise another $7 billion by shifting some funds from the Hospital Insurance Trust Fund on a temporary basis to the Old Age Survivors, and Disability Insurance Trust Funds.

We have a tremendous cushion with which to do that. The hospital costs containment program will save the American taxpayer $10.1 billion over this 5-year period in unnecessary Federal payments.

We increase the self-employment tax rate to 1½ times what the employee pays. That is the traditional level of that tax rate.

Lastly, we have a new eligibility test. The subcommittee is familiar with the *Goldfarb* case, that held that the social security law discriminates against women because of the imposition placed on their husbands in proving dependency. We propose a simple dependency test. Whichever spouse has the lower income over a 3-year period, which we would probably take off the tax return, or a simple form like that, that spouse would be designated the beneficiary. That saves us $3 billion.

Senator DANFORTH. Before you move that chart, the $14 billion in countercyclical general revenues, when would this go into the Social Security Trust Fund? Would it be instantaneous or would it be spread?

Secretary CALIFANO. This would go into the Social Security Trust Fund in 1978, 1979, and 1980.

Senator DANFORTH. Each year?

Secretary CALIFANO. Part of it each year.

Senator DANFORTH. Do you know how much each year?

Secretary CALIFANO. We can provide it.

Senator DANFORTH. It would be 14 divided by five; roughly, about $3 billion a year?

Secretary CALIFANO. We can get you these figures.

[The following was subsequently supplied for the record:]

PLANNED PAYMENT SCHEDULE OF COUNTERCYCLICAL GENERAL REVENUES

[In billions]

Year	Prorated amount for 1975–76 unemployment	Amount for prior year's unemployment	Total
Old-age, survivors, and disability insurance (OASDI):			
1978	$2.9	$2.6	$5.5
1979	2.8	.8	3.6
1980	2.8		2.8
Hospital insurance (HI):			
1978	.5	.5	1.0
1979	.5	.2	.7
1980	.5		.5
OASDI and HI combined:			
1978	3.4	3.1	6.5
1979	3.3	1.0	4.3
1980	3.3		3.3

Senator DANFORTH. It is 14 over 3 years?

Secretary CALIFANO. That is correct.

Senator DANFORTH. On the $30 billion by increasing the base?

Secretary CALIFANO. That goes into effect in 1979, 1980, and 1981. The years and amounts on that are in my statement.

During the 3-year period, we essentially take one-third of the difference in each of those 3 years. And 87 percent of the total payroll in covered employment now is taxed by the social security system. We basically take that remaining 13 percent in steps of a third each in those 3 years.

Senator DANFORTH. $10 billion a year. Would that not continue into perpetuity.

Secretary CALIFANO. That would be a permanent aspect of the law.

Senator DANFORTH. That $10 billion more a year revenues for social security?

Secretary CALIFANO. That is right. The alternative, as far as I know, the alternative is $30.4 billion.

Senator DANFORTH. What alternative?

Secretary CALIFANO. If you went with the conventional plan, equally taxing the employer and employee without countercyclical provisions, the employers would end up paying $40 billion instead of $30 billion.

Senator Danforth, we would increase the base for the employer tax to $23,400 in 1979, $37,500 in 1980, and to the total payroll in 1981.

Senator DANFORTH. In 1981 and years thereafter, the estimated revenue for those years would be what?

Mr. CARDWELL. I do not understand your question.

Secretary CALIFANO. In 1981 and after, how much revenue per year is raised by taxing employers.

Mr. CARDWELL. The figures go like this. We would add $2.6 billion in 1979, $6.1 billion in 1980, $10.3 billion in 1981, and $11.4 billion in 1982.

The consequences of lifting the earnings limit thereafter depends on your outlook for the future total costs of social security. We know that if we did not lift the earnings limit, the annual revenue loss would be in the $10 billion range by the early 1980's, and it would go up and up and up.

Senator DANFORTH. All right.

Senator Curtis wants to know if the benefits would increase.

Secretary CALIFANO. No. That is another advantage we get out of taxing the employer and not the employee. As we increase the base of the employee, we increase the benefits of the employee. There are other ways of increasing benefits as well. By not further increasing the base of the employee, we do not increase benefits by reason of that action. We can increase the tax base of the employer without increasing the employees' benefits.

Senator CURTIS. On the next line, you do.

Secretary CALIFANO. On this line we do in the short term, in two $600 increases, one in 1979 and one in 1981.

Senator CURTIS. You have not increased the benefits?

Secretary CALIFANO. It will, but in a way that we think is deserved by the American worker.

Senator CURTIS. Do you now have those figures on what the dollar increase the employer would have to pay on a $40,000-a-year employee over the present?

Secretary CALIFANO. The wage base in 1981 would be $21,900. If an individual makes $40,000 under our proposal, the employer would pay $2,500 in taxes, the employee would pay $1,426. Under that conventional alternative, the employee would pay an additional $540 in taxes. He would pay $1,993. His employer would pay less; he would pay $1,993. Under present law, the $40,000-a-year employee would pay $1,380; the employer would pay $1,380. Under our proposal, the $40,000-a-year employee would pay more than $500 less than under any conventional proposal.

Senator LAXALT. Mr. Secretary, you made reference to a possible savings of $9 to $10 billion. Where is that reflected?

Secretary CALIFANO. Right here, because we are constantly cautious and conservative here, we only use $7 billion. We believe we will save at least $10 billion in this period if the Congress enacts the hospital costs containment proposal.

Senator LAXALT. Do you have an alternate proposal if the Congress does not see fit to pass that?

Secretary CALIFANO. It is another example where Congress will have to make a tough decision. If they do not grant the hospital costs containment proposal they will have to raise revenues to pay the hospitals in this country another $10 billion over that 5-year period. That is to permit the hospitals to increase their costs at 3 times the cost of living for the rest of the economy rather than 1½ times.

Senator DANFORTH. Mr. Secretary, I am sorry to interrupt. I know you have your sequence.

But I just want to make one point. On this chart, insofar as the taxes raised on employers, the social security tax paid by employers is deductible for Federal income tax purposes. The social security tax paid by individual taxpayers is not deductible, so that you have a tax rate of 52 percent, you have about half of the tax, in effect, being picked up out of general revenues by the deductibility of employers' taxes being paid. So the result of any increase in the employers' tax is a reduction in revenues and it amounts to a transfer of half of that increase from general revenues.

Secretary CALIFANO. Senator, absolutely. Since the social security system started it has been substantially subsidized by general revenues because employers have been deducting the taxes that they have been paying and, in effect, the general treasury has paid for a large part of the social security system since the day it was started.

Senator DANFORTH. Right. That has been figured into the administration's computations on what is going on? I know the President has stated his interest in balancing the budget by 1981. Here you have a loss of $5 billion a year as a result of this.

Secretary CALIFANO. Indeed, we would lose more money if we did not have our plan. If we went the traditional approach we would lose additional general revenues. If you think the President has talked about balancing the budget to you, you should hear what he has said to me.

Senator DANFORTH. I am not arguing with you. I wanted to see if this has been considered.

Secretary CALIFANO. It has been.

This chart, just briefly, illustrates what happens under current law throughout this period. At the end you can see the tax rate stays the same under the current law and under the Administration's proposal; as Senator Curtis noted, the wage base goes up by $1,200 under the administration proposal, the tax rate goes up to 6.85 percent, an increase of over 6.3 percent and the wage base goes to $31,200 under the conventional proposal.

Senator CURTIS. I will ask one more question on that. I would like to know what percent of the employees under your plan would get a reduction in social security tax; what percent would get an increase; what percent would have no change?

Secretary CALIFANO. Senator, under our plan, the average worker will pay absolutely no additional taxes during this entire 4-year period; not 1 cent. Under the conventional plan, the average worker would pay, in 1979, $47 in additional taxes; in 1980, $50 in additional taxes; in 1981, $74 in additional taxes; in 1982, $77 in additional taxes. This was one of the critical parameters in trying to put this together.

Senator CURTIS. There is an enormity of employees that will have increased taxes.

Secretary CALIFANO. Those employees are the big wage earners, the employees earning more than the maximum amount under social security would have, under the administration plan, an increase of $36 in 1979, but under the conventional plan their taxes would skyrocket by $230. In 1980, it stays at $36 under the administration's plan and goes up to $256 under the conventional plan. In 1981, 1982, where it would only be $76 under the administration's plan, it is about eight or nine times that amount under the conventional plan, $613 in 1981, $663 in 1982.

Senator CURTIS. Not the averages, but what percent of the workers would have an increase in social security tax? An average does not mean anything.

Secretary CALIFANO. There is no increase in the tax rate on any worker in this country during this period of time under the President's plan—the tax rate increases in the hospital insurance program, as I noted in the beginning, are already scheduled to go into effect. So there will be an increase in that sense, an increase on every worker in that sense.

Mr. CARDWELL. Senator Curtis, the Secretary pointed out that about 13 percent of the current work force have earnings above the wage base. Your workers earning more than the maximum, say about 13 percent of the work force, would experience some increase, the increase that the Secretary describes there.

Secretary CALIFANO. They are, Senator, those most able to pay. They are the ones most able to pay. What they have under our plan is an incredibly modest increase in taxes compared to what would happen under the conventional plan. Your $40,000 a year worker pays only an additional $36 in 1979. I think he can afford it.

Senator CURTIS. All that means is, if you take some money out of the general fund, you do not have to raise quite as much. That is all you are saying.

Secretary CALIFANO. You also have to have the tax on the employer.

Senator CURTIS. Yes; at $40,000 it is approximately doubling the tax for the employer on that particular employee.

Secretary CALIFANO. The answer is, yes. The employee, however, pays $537 less under the administration plan than under the conventional plan.

Senator CURTIS. I did not get a responsive answer. I asked what would be the increase in taxes for the employee over the 1977 rate, and the base is $16,500 there; you would go up to $40,000, so it would be more than double what it is now.

Secretary CALIFANO. I can read you the numbers again, or submit them for the record. In terms of what happens to employers, I think we have covered that in response to Senator Danforth's question.

[The following was subsequently supplied for the record:]

EMPLOYEE AND EMPLOYER SOCIAL SECURITY CONTRIBUTIONS FOR $40,000 WAGE EARNER IN 1981: PRESENT LAW, ADMINISTRATION FINANCING PROPOSALS, AND TRADITIONAL FINANCING ALTERNATIVE

	Present law	Administration Proposal	Traditional alternative
Rate (percent)	6.30	6.30	6.85
Base	$21,900	[1] 23,100	$29,100
Employee contribution	$1,379.70	$1,455.30	$1,993.35
Employer contribution	$1,379.70	$2,520.00	$1,993.35

[1] For employee; none for employer.

Senator BYRD. Would the Senator from Nebraska yield?

Senator CURTIS. I do not have the floor.

Senator BYRD. Mr. Califano, you have been comparing your plan and seeking to sell the merits of your plan by comparing it to the conventional rate-base financing plan.

Who developed that and who advocates it?

Secretary CALIFANO. As I indicated, I am saying we used that term to mean any combination of wage base increases and/or tax increases equally distributed.

Senator BYRD. Has anyone advocated that plan?

Secretary CALIFANO. That is the conventional way. There are advocates of that plan, yes.

Senator BYRD. It seems to me that what you are doing is setting that up in order to make your plan look more desirable. I do not know anyone who is advocating it.

Secretary CALIFANO. We are setting that up to say that, if you want to raise money to keep the social security trust funds at a level we think is viable and to equally distribute tax and wage base increases between employee and employer, is one way to do it.

I indicated, when I began, the other alternatives, the two other alternatives; to one that was proposed in the Ford administration budget in January 1977 that we consider to be inadequate, and the one that is proposed by the NAM and most businessmen, or a lot of businessmen that they represent, which would drive those trust funds down to 18 percent. We just think you cannot play that dangerously.

Senator BYRD. You mentioned 13 percent that you are not now planning. How much money in dollars would that bring in?

Secretary CALIFANO. We will bring in $30.4 billion by taxing that proportion of the employer wage base. 87 percent, as I said, of the wage base, the total wage base in this country is already taxed by the social security system. By picking up that last 13 percent we would pick up $30.4 billion.

Senator BYRD. Per year?

Secretary CALIFANO. Over this 5-year period. That is the total, and it goes this way: from $2.6 billion in 1972 to $11.4 in 1982. Then as your projections go out, that figure will go up.

What I have described briefly is our proposal to deal with the short-run crisis in the social security trust fund in the social security system. We have made some suggestions that deal with long-term financing problems.

Projected over 75 years, with all of the problems of projecting anything out over 75 years, the trustees report indicates that the system will be in deficit by 8.2 percent of payroll. Half of that deficit is due to a faulty method of adjusting benefits for inflation and it brings us to a proposal to decouple. The rest of it is due to a shifting age population, the demographic changes in the country. Today, there are three workers for every retiree. By the year 2030, there will only be two workers for every retiree.

Senator CURTIS. On whose authority do you make that last statement?

Secretary CALIFANO. Two workers and three workers?

Senator CURTIS. Yes.

Secretary CALIFANO. That is in the trustees report. It is the best we can do demographically. We have actuaries, in the Social Security Administration.

Senator CURTIS. There are not any experts that can estimate the birth rate. The Social Security Act, when it was originally enacted, was based on the fact that the depression birth rate would exist and would continue. Following World War II, the facts developed that they were totally wrong, and it saved the social security fund from collapsing a long time ago; it was their own error.

I think that most of the authorities would agree that there is no statistical base on which to determine future birth rates.

Secretary CALIFANO. Senator, there is no question about the difficulty of estimating anything 75 years from now. All one has to do is look at the last 5 years. I think these men and women in the acturial business have done the best that they know how to do. Nobody can predict 75 years.

Senator CURTIS. I would like to ask one more thing. All of these figures are based upon how many future raises in benefits?

Secretary CALIFANO. They are based upon existing law with the changes we propose.

Senator CURTIS. No increase in benefits for the next 75 years?

Secretary CALIFANO. We will show you what happens to benefits in another chart, only what is written in existing law.

Senator CURTIS. You are basing your costs upon the assumption that the Congress will not raise benefits in the future.

Secretary CALIFANO. Whether Congress raises benefits in the future is something for the Congress to determine. I would hope when

Congress raises benefits in the future they will also raise the money to cover those benefits.

Senator CURTIS. Of course, they have not done that.

Secretary CALIFANO. They have done pretty well.

Senator CURTIS. Just before the last Presidential election, the chairman of the Ways and Means Committee sent us a bill increasing benefits 5 percent with a certain adjustment in revenue. Then he decided to run for President. He raised it to 20 and said he did not need to change the income.

I think if you are realistic, your costs there will show that we raise benefits regularly every 2 years just before election, and sometimes every year.

Secretary CALIFANO. One of the key elements in benefits is the way in which we have been adjusting for increases in the Consumer Price Index. We make the same consumer price adjustment for workers that we have in the past. We are giving the current existing worker a double shot of inflation increase. Let me try to explain this as best I can. Our proposal is to give only one increase for the cost of living. For example, a person who had earned $10,000 a year before retirement is getting benefits equal to 40 percent of earnings, or $4,000 a year. If there is an increase of 6 percent because of the automatic cost-of-living increase in inflation, you multiply that 6 percent by the 40 percent. That person will receive benefits of 42.4 percent of prior earnings, or $4,240 if currently retired.

For active-duty workers, they would also get that increase in their future benefits, but their wages are increasing. If their wages have increased to $10,600, and the benefit formula had increased to 42.4 percent, they would be entitled, when they did retire, to $4,494.

It is our proposal, essentially, to let the active duty workers' future benefits reflect wage increases due to inflation and productivity but not adjust again for inflation. If we do not change this, we will have workers in this country who will be receiving more than 100 percent of their active duty pay.

We have benefit levels that are reasonably high now. The proposal, I should note, would also keep benefits at about the relative levels they are today, a commitment the President made during the Presidential campaign.

Senator NELSON. May I ask a question? As I recall from your testimony, that was one of the two major causes of the deficit.

Secretary CALIFANO. That is correct, Mr. Chairman. Almost half the deficit in the long term.

Senator NELSON. I am interested in a little bit of history so that we might avoid this kind of thing in the future.

Where did this proposal, this consequence come from? The Social Security Advisory Council, the Congress, or where?

Secretary CALIFANO. It was a proposal that many people in Congress suggested, a proposal also recommended by the Nixon administration. The manner in which it was done, I honestly believe, from everyone whom I have talked to, was inadvertent. People did not fully appreciate what would happen.

Senator NELSON. I suspect that is so, since nobody seemed to know it at the time of its passage into law.

My question is, what were the methodologies, the procedures, for getting this result? We ought to know so we can avoid such a blunder in the future.

Senator CALIFANO. I think the recommendation was made by the Nixon administration. Congress enacted it. I do not know exactly—I do not know if there is anyone to blame for the mistake here.

Senator NELSON. Someone is to blame for the mistake, Congress, maybe a lot of people.

Did the Social Security Advisory Council itself evaluate this, or their statisticians?

Mr. CARDWELL. Mr. Chairman, the previous Advisory Council recommended that the system be indexed and that is what this formula was intended to do when it was adopted in 1972.

They did not prescribe the formula. This particular approach to indexing tends, as I see it, looking back on it, to follow the traditional behavior of the Congress in the way in which they authorized benefit increases for social security.

They would tend to authorize the higher benefit rate for both current workers and current retirees. That is what the present formula does.

Senator CURTIS. It has always done that, has it not?

Mr. CARDWELL. Yes, sir.

Senator CURTIS. To do otherwise would be to say to the employee, if you get an increase in wages it does not, per se, give you an increase in social security.

Mr. CARDWELL. No. If one receives an increase in wages and is below the wage base it would raise his or her social security.

Senator CURTIS. If you make this change, it will not?

Mr. CARDWELL. The higher wages would still increase the worker's future social security benefit rates. Current CPI adjustments for retirees would not.

Secretary CALIFANO. The wage inflation, if you will, continues. The increases in the wages will continue to be reflected in the benefits received. An individual will not, at the same time, have the potential benefit increase every time the Consumer Price Index goes up the way the current retiree does.

Senator CURTIS. You are talking about the automatic increase?

Secretary CALIFANO. That is what I am talking about.

Senator CURTIS. The automatic increase would apply only to retirees?

Secretary CALIFANO. Yes; that is correct.

Senator CURTIS. He would get the basic increase. He would get it by reason of a promotion, if his wage increase were not based on the credit?

Secretary CALIFANO. I do not think that even the most optimistic planners think there will be no inflation whatever in wage increases.

Senator BYRD. May I follow up on Senator Nelson's question?

Senator NELSON. This formula came into effect in 1972, never prior to that and ended up with this consequence.

Secretary CALIFANO. That is absolutely correct, Mr. Chairman.

Senator NELSON. I just want to make one point. This has nothing to do, particularly, with this hearing, but the way we deal with pen-

sions is a disaster. You have the Armed Services Committee doing one thing for soldiers. You have the old Post Office and Civil Service Committee doing something else for Federal employees. Then you have the Finance Committee handling social security and none of them knows what the other is doing. We ought to cut out the whole business and take it out of all of these committees and stick it in the Budget Committee or someplace else.

I cannot understand how, even with the old math, some 8th grade graduate could not have made a computation to tell us we would get this disastrous result. What bothers me, in dealing with this matter of tremendous consequence, is that everybody in the United States, the executive branch, the Congress, the Social Security administration, all the actuaries could have let this blunder happen.

I think we have to design some method to avoid that in the future.

Senator BYRD. I would like to ask a question at this point.

Senator Nelson mentioned the Advisory Council. Did the last Advisory Council in 1975 not recommend against general revenue financing?

Mr. CARDWELL. As a practical matter, they actually recommended consideration of a form of general revenue financing. Their idea was to shift the financing for hospital insurance onto the general fund and reassign the hospital insurance tax rates over to the retirement, survivors', and disability insurance systems.

Senator BYRD. Insofar as the general social security trust fund is concerned, did not the Council recommend against general revenue sharing?

Mr. CARDWELL. No, I do not think that is a fair statement. They recommended a revision of the formula right along the lines of this proposal, but they recommended, in consideration of the long-term deficit that one alternative might be to use general revenues to help finance the health insurance portion of the program.

Senator BYRD. Only the health insurance portion?

Mr. CARDWELL. Yes.

Senator BYRD. They did not recommend it?

Mr. CARDWELL. They did not recommend it for cash.

Senator BYRD. That is what I was getting at. Thank you.

Senator LONG. May I ask one question? Here is what bothers me about this proposal. We will be under the burden of going to the Senate and asking the Senate to vote more taxes to fund this program. That does not particularly bother me. If we do not do it the way you recommend, we will agree on something to see that there is enough money to pay for these benefits. But the way we have mustered the votes to pay for this program down the years was to take a bill that would expand benefits and say to the Senate, if you want these benefits then you have to vote for the tax to pay for it. That is how we found the votes to pay for it.

When you talk about financing social security out of general revenues. I think that is very misleading. We do not have any general revenues to finance it with.

The income tax is not paying for the full cost of general government. The Federal Government is running a $60 billion deficit. The only way you are going to find the general revenues is just by stepping up

the printing press and running off a lot of printing press dollars to pay for social security, which is the way the deficit in the Federal fund is being covered now.

If we are going to let the Senators and the House Members feel that they can vote these further benefits for hospital costs, disability and other things by just running off more printing press money, how do you expect us to find the votes to get those fellows to vote for the tax to pay for some of these?

That is the burden on us: to find people to vote for the taxes to pay for benefits that they want to fund. It is not easy to do.

If we offer them the easy way out, to say we will just finance this thing by running off more printing press money, that is how I read this general fund. There is no general fund except that printing press down at Federal Reserve. How are we going to fund this thing and find the folks to pay for all of this without funding first the general fund, the so-called Federal fund, then the trust funds, out of printing press money? Are we not going to have ourselves an insurmountable political problem to persuade these Senators and House members to vote for these tax increases?

They are going to say, you do not need that. Just print up some more money.

Secretary Califano. Senator, I would not pretend to argue with you about the politics of this but I would make the point simply: one, we are only talking about $14 billion. We are talking about $14 billion as, in effect, an insurance policy. As you undoubtedly know, the $14 billion only becomes an expenditure, if you will, if the trust funds actually reach the point where that money has to be spent. Since this is not expected to occur, it will not show up in the budget.

There is no need for you and your colleagues to pass any law raising an additional $14 billion in taxes over a 5-year period. There is no need to pass a law to raise an additional $3 billion a year, if you will, to do this. This is, in effect, an insurance policy.

We would hope that the time would never come when we would be in the kind of recessionary situation where you would have to have that money. If the situation were that bad, if the economy of this country were so bad that we had to dip into the general funds in order to pay these benefits, it would make probably a lot of sense to have those benefits paid and to have a deficit like that. It is not that much money. That is the best I can answer.

Senator Danforth. Mr. Secretary, regardless of the $3 billion and the countercyclical general revenue into this you are going to lose, from the Treasury, about $5 billion a year, good times and bad times, because of the increased deduction resulting from the increased employer share of social security.

Secretary Califano. That is correct, Senator. No question about that. That is in our calculations and that is slightly less over that 5-year period than the funds that would be paid if we had an equal distribution. That is right.

Senator Long. Here is how I read it. We have succeeded now in raising taxes by calendar year 1977, $32 billion more—I am looking at page 33 of the blue book—$32 billion more than was paid out, so we are ahead of our debts by that much in our funds.

President Johnson and other administrations pressed for a consolidated budget so they could include these surpluses in the social security fund in an overall budget, and I thought that was sound and supported it, to make their overall programs look a little better than they would have otherwise, because we were collecting down through the years more money than we were paying out in this area.

It bothers me with the Federal funds fairly badly in deficit to start financing this program with printing press money as well. That is why it seems to me, just by way of responsibility, we should try to muster the courage to vote whatever taxes are needed to fund this program before we offer Senators and House Members the easy way out in saying, we will just increase the debt limit, tell the Federal Reserve to print more money down there.

You and I know, if we start financing things in a general approach, in that fashion, inflation will get so bad that the faster we print money to pay the debt, we will have to print more money to meet the increase in the cost of living.

I do not think you want to get us to that kind of inflationary spiral; I know I do not. That is why I ask you, is it absolutely essential that we fund this thing by reaching for so-called general funds when there are no general funds there?

All you can do is create more money in the banking system in order to do it.

Senator Laxalt. Chairman Long, is there not built into this package $30 billion that amounts to a tax increase on employers in this part of the package?

Senator Long. There are taxes in the program, yes. What I am concerned about is not so much the taxes. The benefits are there. We are going to have to reduce some of the benefits and a windfall that was never intended.

On the tax increases, it seems to me that if we need more taxes, we should measure up for it and call upon the Congress to vote for it. I dislike this idea of letting the Senate and the House think we can escape our painful duty of voting the taxes to pay for the social security program.

Secretary Califano. Senator, all I can repeat is what I said. The $14 billion will only be needed, in tax terms, if the money has to be spent over the 5-year period. We believe that the proposal that we have, with the taxes that we include in it, will make the system sound for the next 25 years. We do not shrink from recommending taxes if we think they are necessary. We honestly do not think that taxes are necessary beyond what we have proposed.

Senator Long. Over the past years, Mr. Secretary, I have had to fight on the floor against amendments to provide benefits that would be paid out of the deficit. I dislike the idea of getting this on the basis of where Senators and Members of the House can come up with these politically appealing proposed benefits, and take the view that that can be financed without any tax.

The last big increase was financed by changing the assumptions on which the program was based. We cannot do that anymore, can we?

Financing it just by changing it will not work. We are going to have to find money somewhere for it.

Secretary CALIFANO. That is right, Mr. Chairman. We feel that we have found enough money here. As you know, we are asking for a decoupling plan of stabilizing the benefit rate level. We are asking for an additional $30 billion in taxes on employers. We are increasing the wage base on employees by $600 in 1979, $600 in 1981 which will effectively increase the amount of money that will pay for this system.

Senator BYRD. Let me ask you a question. The money you are asking for from the general revenues, would they be subject to the appropriations process like the other revenue amounts?

Secretary CALIFANO. There would not have to be an appropriation, for the countercyclical general revenues.

Senator BYRD. It would be subject to the annual appropriations process?

Secretary CALIFANO. Not subject to an annual process, you would authorize a transfer to the trust funds from general revenues. Except for administrative expenses and certain benefit payments, there are no annual appropriations to the social security system now.

Senator BYRD. Even though the funds would be coming from the general revenue?

Secretary CALIFANO. As I said, there are general revenue funds in the social security system now.

Senator BYRD. Only on the basis of figuring that business deducts from their taxes.

Secretary CALIFANO. There are the so-called Prouty benefits.

Senator BYRD. Is that not a minute part of the total?

Senator CALIFANO. There is also the supplementary medical insurance program. There is a portion of the hospital insurance program.

Senator BYRD. Appropriated annually?

Secretary CALIFANO. The Prouty benefits are not. The hospital insurance program has a number of eligibles who have not paid in and these are funds appropriated annually. The minute pieces of it are appropriated annually. There was a period pre-1957 for which we folded in contributions for military personnel out of general revenues. There are funds from the general revenues that we folded in for the Japanese internees. They are small amounts, appropriated annually. We thought we were following the traditional way of moving in this area other than in these special cases.

Senator BYRD. What we are saying is that we can do all of this and no one has to pay for it.

Secretary CALIFANO. The people have to pay for it, as is indicated in the tax increases which we have proposed.

Senator BYRD. What are the tax increases? What do they amount to, the total?

Secretary CALIFANO. The tax increases amount to $30 billion on the employers. The increases from the increase in the wage base of the employees in 1979 and 1981 and returning to the traditional relationship of the self-employed tax rate to the nonself-employed tax rate.

Senator BYRD. Your program comes to a $30 billion increase on the employers. As I recall your answer to my question earlier, a $30 billion increase on that 13 percent of the employees who do not pay on the full amount?

Secretary CALIFANO. No, only a modest increase on those employees. There is no tax rate increase for employees in the short-run in this plan. Those increases come only by increasing the wage base, once in 1979 by $600 and once in 1981 by $600.

Senator BYRD. The increase is $30 billion.

Secretary CALIFANO. For employees, that is correct.

Senator HATHAWAY. On that point, is there any problem with respect to the definition of earnings so that employers cannot dodge by giving deferred income plans to their employees, or stock options?

Secretary CALIFANO. We stick essentially with the definition of earnings that we have now. We will look carefully at that.

As I indicated, this would bring us into balance through at least the year 2000 and, we believe, reduce the long-term deficit to manageable proportions. In the long run, there are other features of the plan. There is the scheduled tax rate increase of 1 percent to go into effect in the year 2011. We would bring one-quarter of that increase back into 1985, equally on employer and employee and three-quarters of that 1 percent into effect in 1990. There are a lot of other questions, questions of the kind that Chairman Nelson raised that we would give the Social Security Advisory Committee to consider.

This is a snapshot of the impact over the 25-year period. If all of this were enacted, instead of a deficit under present law of 2.3 percent of payroll for the next 25 years, we would have a surplus of 0.5 percent of payroll.

In the long run, through the year 2051, with all of the problems of estimating out that far, under present law, we would have a deficit of 8.2 percent of payroll. If our plan went into effect, we would be left with what we estimate would be a deficit of 1.9 percent of payroll. Again, we think that is fine in the context of how difficult it is to estimate out there.

In summary, we believe the plan solves the short-term problem without a tax increase; it fulfills the President's commitment in that regard. It brings the cash benefit program into actuarial balance through the turn of the century which fulfills his commitment. It reduces the long-term deficit to manageable proportions without reducing the benefits of future retirees, which was another commitment made; and it fulfills the overall commitment, which was to restore the social security system to a sound financial position.

Senator LAXALT. You indicate we are solving the short-term problem by no tax rate increase. Unless I misunderstand the testimony entirely, we are socking the employers of this country to the tune of $30 billion.

Secretary CALIFANO. Without a tax rate increase to the employee. That was the President's commitment.

Senator LAXALT. You cannot talk about employees only. The employers are going to be taxed severely.

Secretary CALIFANO. Less than they would be under the conventional plan, Senator.

Senator NELSON. What you are saying, if you follow the current method of financing the employer would pay $34 billion in that period rather than $30 billion. Is that correct?

Secretary CALIFANO. That is correct, Mr. Chairman.

Senator HATHAWAY. Mr. Secretary, do you have any figures to show, with the decoupling, how long that would maintain the solvency of the fund?

Secretary CALIFANO. It does not help us very much in the early years. You have to get far out to get the help. We can give you those. It would run out in 1979 or 1982 or 1983.

[The following was subsequently supplied for the record:]

In responding to this question, estimates were made for the following proposed changes:

1. The maximum annual amount of earnings on which an employer pays social security taxes, i.e., the earnings base of employers would be increased in three steps until it is removed entirely in 1981, as under the Administration's financing proposals. The earnings base for employers under present law and under the proposal for the years 1978–81 are as follows:

Calendar year	Present law [1]	Proposal
1978	$17,700	$17,700
1979	18,900	23,400
1980	20,400	37,500
1981	21,900	[2]

[1] The figures shown are the amounts assumed under the intermediate set of assumptions in the 1977 trustees report.
[2] For wages paid in 1981, and in all later years, employers would pay social security taxes on all wages paid to an employee.

2. During the period 1979–85, part of the contribution rate for the hospital insurance (HI) program would be reallocated to the OASDI program in order to transfer to the OASI and DI trust funds part, but not all, of the additional taxes that the HI trust fund would otherwise receive because of the elimination of the base for employers. The amount reallocated would be .05 percent, each, for employees, employers, and self-employed persons in each year 1979–85. The contribution rates under present law and under the proposal are as follows:

[In percent]

Calendar year	Present law			Proposal		
	OASDI	HI	Total	OASDI	HI	Total
Employees and employers, each:						
1978	4.95	1.10	6.05	4.95	1.10	6.05
1979–80	4.95	1.10	6.05	5.00	1.05	6.05
1981–85	4.95	1.35	6.30	5.00	1.30	6.30
Self-employed persons:						
1978	7.00	1.10	8.10	7.00	1.10	8.10
1979–80	7.00	1.10	8.10	7.05	1.05	8.10
1981–85	7.00	1.35	8.35	7.05	1.30	8.35

3. The Administration's decoupling proposal would become effective on January 1, 1979.

On the basis of the intermediate set of assumptions in the 1977 Trustees Report, it is estimated that the combined assets of the OASI and DI trust funds will be exhausted in 1982. If present law were modified by the changes described above, we estimate that the combined trust funds would not be exhausted until 1985, 3 years later than under present law.

Senator HATHAWAY. There was a study that said if we decoupled and had a very modest increase in the tax it would carry the fund through about the year 2000. I do not recall the author of the study.

Mr. CARDWELL. That decoupling plan would be one that would reduce benefits. If you change the formula to reduce benefits you reduce the financing needs of the system.

Senator NELSON. Reduce what benefits?

Mr. CARDWELL. The retirees benefits.

Senator HATHAWAY. Which you propose to do.

Mr. CARWDWELL. No. Our plan would not reduce the retirees benefit rights.

Senator HATHAWAY. I thought you were proposing decoupling?

Mr. CARDWELL. We would decouple and maintain benefit rights on into the future at current levels. There would be no deliberalization of benefits.

There have been proposals to decouple in a way that would deliberalize existing benefits. They would reduce the share of a person's earnings at the time of retirement that is now replaced by social security. That is not our proposal.

Senator HATHAWAY. Your proposal does save 4 percent.

Mr. CARDWELL. This proposal will cut the long-term deficit by about one-half.

Senator HATHAWAY. That is not effective now. You get the big savings in later years. How late?

Mr. CARDWELL. They really start to be significant about the turn of the century and they build up as time goes on. If you leave the formula unattended, its cost to the system accelerates as time goes on.

Senator LAXALT. I am troubled by the approach here in reference to the increased tax on the employers. Certainly we have to do something about these older people. What we have done to them already is a travesty. What we are in the process of doing to the younger people is just as bad. Yet, I think we are injecting philosophically a whole new element into this situation, unless I misinterpret you.

The $40,000 employee will now have the rate doubled, I gather, roughly over the conventional—so-called conventional—plan without a commensurate increase in benefits. Is that not true?

Secretary CALIFANO. That is not correct, Senator. The $40,000 employee will pay only $76 more in 1982—over $500 less under our plan than he would under the conventional plan. The $40,000 employee, in that sense, is better off under our plan.

Senator LAXALT. In terms of the tax that is going to be paid for him by his employer. I do not think you can just separate the situation. That increase is going to be reflected, I think, in some manner by his wage structuring, in particular, but what concerns me is that you are going to have a level here that is about double in relation to other persons within the system with no commensurate increase in benefits.

How do we justify that?

Is this not a too-subtle redistribution of income?

Secretary CALIFANO. Senator—let me try it this way. The present social security system discriminates sharply against small business. He is paying on 100 percent of his payroll. The larger businessman, with the high-priced talent, is not paying on 100 percent of his payroll. When I say we are picking up, by taxing 100 percent of the employer payroll, the difference between 87 percent of the payroll and 100 percent of the payroll, I am also saying there is something else built into that. The small low-work employer is already paying

a tax on 100 percent of his payroll and the large businessman with higher paid employees is paying a tax on far less than 87 percent of his payroll. So I think we have to end the discrimination in the social security system against the small employer, the small businessman. That is one of the things I think we achieve.

Senator LAXALT. Is not the bottom line of your whole approach that middle America is going to be subsidizing the lower brackets? Is that not what we are going to do?

Secretary CALIFANO. The bottom line of my approach is to save middle America. When we are talking about someone making $16,500 a year we are talking about someone who is above the median wage in this country. What we are trying to do is save middle America from an additional tax burden. We have enough of a tax burden. We do not want to place another one on him by further increasing the tax rates. That is what we are after. I think we are achieving that. This will be the first proposal in this area that has not said to middle America, listen, we are going to wallop you again to pick up the tab.

Senator LAXALT. You are to be commended for taking the first step because obviously this is a highly technical, highly complex matter and it is going to require tremendous amount of deliberation on the part of this subcommittee. Obviously it is priority No. 1.

One of the other problems that concerns me is the fact that we are only looking at the income side. Is the administration or the agency itself looking into the benefits side so that perhaps we can look at some equalizing factors on the benefits side as well?

Secretary CALIFANO. Senator, the decoupling proposal will stop the tremendous increases in benefits as a result of the double increase for inflation. That will stabilize benefits where they are, relatively.

Now, in the context of several larger problems which I know you are alluding to, the Social Security Advisory Committee will look at a lot of those problems and look, perhaps, at some of the problems that Chairman Nelson mentioned in the context of what is the relationship of this system to the other Government retirement and pension systems, which is a very serious question.

Senator DANFORTH. Mr. Secretary, would it be a total breach of philosophy with respect to social security if it were made more of a progressive system than it is now? That is to say, if the base were increased for the purpose of taxation but not for the purpose of benefits. Has that been considered?

Secretary CALIFANO. We looked at that, Senator, and we rejected it as less viable in a lot of ways than the proposal we are now making. It would not be a breach, a total breach of philosophy, to make the system more progressive. There are some progressive elements, if you will, built into the system already one way or the other.

At the very minimal level, Congress has set the minimum benefit at more than someone who is making a low salary is going to pay into the system. The proposal we have here is less regressive, and hence more progressive, in the way that it taxes the employer.

Senator DANFORTH. You have rejected the concept of increasing the base on the employee as well as the employer without increasing——

Secretary CALIFANO. Yes, we did. These are social judgments that one makes. We thought the employee was paying enough now in the increases that we made.

Senator DANFORTH. Under the present system, an employee who is making $16,500 a year is paying the same amount of social security taxes as an employee who is making $100,000 a year.

Secretary CALIFANO. That is correct.

Senator DANFORTH. You believe that would be unfair, to increase the base to cover all income for the employee?

Secretary CALIFANO. Without increasing his benefits.

Senator DANFORTH. Why is that?

Secretary CALIFANO. In all candor, one of the things, quite frankly, was if we start out at that rate, we might end up, by the time we worked our way through the Congress, with an increase in benefits so that we would not be any better off than we are today.

Senator DANFORTH. The old concept of social security being kind of annuity program, it is not that kind of doctrinal concept that is preventing you from taking that approach, but purely the political question?

Secretary CALIFANO. That is correct. I guess that we were sensitive to one of the points that Senator Long made in the context of the way we proposed going to the general revenues. We are trying to avoid building in a method of going to the general revenue which would permit permanent benefits to be put into effect on the basis of that. Congress, in the Vandenberg amendment in 1944 provided for a period of about 5 years for the potential use of general revenues for total and complete guarantees of the system. They never had to be used. We would hope we could build a system where we would never have to use that $14 billion.

Senator DANFORTH. Would the administration flatly oppose the concept of increasing the base on employees without increasing the benfits to go along with that increase in base?

Secretary CALIFANO. I think we would be opposed to it. We would prefer our plan. I would be happy to go back and think about it. There is not a philosophical, unalterable kind of view on it.

Senator DANFORTH. Let me ask you one other basic approach.

Did you study the possibility of bringing Federal employees within the social security system?

Secretary CALIFANO. We decided to make that part of some kind of a future study, whether they should be brought in or not brought in. We did look at that question and my own personal views on the concept, being similar to Senator Nelson's are that we should look at—not only the social security system, but also the military retirement system, the civilian employee retirement system, the special retirement systems we have in State and local government, the police forces, et cetera and some of these big private retirement pension systems. The whole world of pensions needs to be looked at but we are not sure how and who should do that.

Senator DANFORTH. It is very common for a private employer to have a pension program over and above social security. His employees must, as a matter of law, be participants in the social security program, but they have a pension over and above that.

Federal employees are not participants in the social security at all but a Government pension program and it is not only an additive to social security, it is the whole thing.

Secretary CALIFANO. That is correct.

Senator DANFORTH. This would increase revenues, would it not, for social security?

Secretary CALIFANO. Yes, it would.

Senator DANFORTH. Am I correct, as a matter of law, that, given the wage and hour case that was decided by the Supreme Court last year, that you could not bring State and local employees in on a mandatory basis?

Mr. CARDWELL. The issue of whether it would be constitutional for the Federal Government to mandate State payment of Federal social security employee contributions is a question that has been undecided for a long time and has not yet been really resolved.

There is also the question of whether once you have agreed to participate, you are bound to participate.

I personally think that those questions are still open.

Senator DANFORTH. Despite that case on the wage and hour?

Mr. CARDWELL. Yes.

Senator DANFORTH. Have you researched that?

Mr. CARDWELL. No, we have not. That is one of the questions we would ask the advisory council to examine.

Senator DANFORTH. Do you have any idea how much more revenue that would bring in if Federal employees were in and State and local employees had to be in?

Mr. CARDWELL. As I say, I cannot give you a figure now, but State and local employees, probably you would tend to break even over the long term. Where the system loses money is when they opt out, because they usually opt out after they have earned the minimum benefit which is a weighted benefit. It is the opting out that costs the system money.

Bringing Federal employees in would probably bring money into the system bearing in mind you have to pay them benefits. They bring in fairly high salaries and the high salaries would be distributed back in the system in favor of the low wage earner. There would be a net gain.

[The following was subsequently supplied for the record:]

COST ESTIMATES SUPPLIED FOR THE RECORD

If Federal civilian employees were compulsorily covered under social security, there would be a long-range savings of 0.11 percent of taxable payroll for the cash benefits program (0.10 percent under a decoupled system as recommended by the Administration) and 0.09 percent for the hospital insurance program.

If State and local employees were compulsorily covered under social security, there would be a long-range savings of 0.17 percent of taxable payroll for the cash benefits program (0.15 percent under a decoupled system as recommended by the Administration) and 0.09 percent for the hospital insurance program.

The following table contains short-range cost estimates for compulsory coverage of these two groups:

ESTIMATED AMOUNT OF NET ADDITIONAL INCOME RESULTING FROM COMPULSORY COVERAGE OF ALL FEDERAL, STATE, AND LOCAL GOVERNMENT EMPLOYEES UNDER THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE (OASDI) AND HOSPITAL INSURANCE (HI) PROGRAMS, CALENDAR YEARS 1980-84

[In billions of dollars]

Calendar year	OASDI	HI	Total
Federal employees:			
1980	5.1	1.1	6.2
1981	5.9	1.6	7.5
1982	6.7	1.8	8.5
1983	7.5	1.9	9.4
1984	8.5	2.1	10.6
State and local employees:			
1980	4.0	0.9	4.9
1981	5.8	1.5	7.3
1982	6.6	1.7	8.3
1983	7.4	1.9	9.3
1984	8.4	2.1	10.5
Total government employees:			
1980	9.1	2.0	11.1
1981	11.7	3.1	14.8
1982	13.3	3.5	16.8
1983	14.9	3.8	18.7
1984	16.9	4.2	21.1

NOTES

1. The above estimates represent the net amount of additional contribution income, over and above income under present law, additional benefit payments, as an offset, and additional interest. The estimated amount of net additional income under a decoupled system would not be significantly different from the amounts shown.

2. The estimates are based on the intermediate set of assumptions in the 1977 trustees reports. In preparing the estimates, it was assumed that the compulsory coverage would become effective on Jan. 1, 1980.

Senator DANFORTH. It would solve the double dipping.

Mr. CARDWELL. It does solve the double dipping and solve windfall benefits that they now often obtain.

Senator DANFORTH. Do you view this as a matter of long-term study?

Mr. CARDWELL. Not terribly long. You could analyze the question and fashion some alternative choices in a relatively short time, producing a public consensus about it is long term.

Senator DANFORTH. Because the government employees would hit the roof?

Mr. CARDWELL. Yes, sir.

Senator DANFORTH. Why would they hit the roof if they got a pension plan over and above social security, just as everybody else does?

Mr. CARDWELL. It is an issue of added tax withholding to them, and although it is unlikely that the Congress or the public policy would evolve a system that added present social security on top of the present civil servce system. It would give them a very elaborate retirement.

Senator DANFORTH. Is it possible, practically, to readjust the whole thing so that they would be a part of social security, then have a pension program, but the aggregate would be approximately what they would now have?

Mr. CARDWELL. It is possible, I suppose. That has been analyzed and recommended several times in the past by various groups, including social security advisory councils.

Senator DANFORTH. Maybe I am looking for a cure-all to solve all of this, all of these problems, but that would seem to me to be one

of the first areas to pursue, the effect of bringing them in, whether it could be done as a practical matter, melding the present pension programs into a combination of social security and pension programs and the effect that this would have to solve the situation.

Mr. CARDWELL. A truly equitable merger that would give the Federal worker benefit rights equal to those he/she now has probably would not do much for the system except to save the system in the future from paying windfall benefits. That is not a critical difference, although important.

Senator DANFORTH. It would bring in instantaneously, if the thing could be worked out instantaneously, what are there, about 2.5 million Federal employees plus, if it could be done constitutionally whatever the number of State and local employees have opted out, so maybe 3 million additional participants in the program that would be paying in.

Mr. CARDWELL. There would be a one-shot infusion, yes, but we would be creating a long-term liability to pay them benefits.

Secretary CALIFANO. Senator, let me make some general points. One, this subject will ultimately be addressed, but I doubt it will be addressed by the Social Security Advisory Committee. I am not prepared, nor is the Carter administration prepared, to accept the windfall benefits characterization that Mr. Cardwell gave to some of these benefits. We are not certain what the equitable way to do this is. I also think it is fair to say that we regard it as a long-term problem, not something to be resolved in a few months. We do not want there to be confusion on that.

Senator DANFORTH. If we repeal the Hatch Act, we had better forget about ever solving that.

Senator NELSON. How many States are under the social security plan now?

Mr. CARDWELL. About 70 percent of State and local workers who otherwise would be eligible are now covered.

Senator NELSON. Have there been withdrawals?

Mr. CARDWELL. Yes, sir, there have been withdrawals throughout the system but, in fact, even including the current withdrawals, new accessions have exceeded withdrawals. There has been a net gain to the system through the years. If you add to the list the people who say they might withdraw, I doubt that that is true.

Senator NELSON. Can you submit for the hearing record the statistics on that?

Mr. CARDWELL. Yes, sir.

[The following was subsequently supplied for the record:]

NUMBER OF STATE AND LOCAL GOVERNMENT GROUPS[1] AND EMPLOYEES NEWLY COVERED UNDER SOCIAL SECURITY OR WHOSE COVERAGE HAS BEEN TERMINATED IN THE PERIOD 1967-76—BY YEAR

Year	Newly covered		Terminated		Net gain or loss of coverage
	Groups	Employees [2]	Groups	employees	
1967	1,000	67,473	11	323	+67,150
1968	1,717	76,925	14	863	+76,062
1969	938	84,351	21	1,369	+82,982
1970	1,031	58,039	29	2,456	+55,583
1971	1,011	56,558	33	2,843	+53,715
1972	944	34,881	41	6,992	+27,890
1973	709	20,231	33	4,616	+15,615
1974	821	21,281	68	8,828	+12,453
1975	1,057	17,010	47	13,426	+3,584
1976	740	19,719	55	8,117	+11,602
Total	9,968	456,468	352	49,833	+406,636

[1] The term "groups" for termination purposes is much broader than for coverage purposes. For example, a city which is a single group for termination purposes may include a number of groups within the city that were covered at different times (e.g., groups of employees under policemen, firemen, teachers' and city retirement systems).

[2] Represents the number of positions covered for the 1st time due to modification of State coverage agreements. Does not include increases in the number of covered positions which result from automatic coverage when (1) the work force in a covered entity is expanded, or (2) a job vacated by an employee who had not elected coverage in an entity in which coverage was effected by the divided retirement system approach is filled by a new employee, or (3) there are non-covered positions in a group that becomes part of another group that had been previously covered.

NUMBER OF STATE AND LOCAL GOVERNMENT COVERAGE GROUPS AND EMPLOYEES WHOSE SOCIAL SECURITY COVERAGE HAS BEEN TERMINATED OR MAY BE TERMINATED BY APR. 1, 1979[1]

Year	Groups	Employees
1959	1	3
1960	0	0
1961	1	5
1962	0	0
1963	2	41
1964	10	132
1965	4	105
1966	5	33
1967	11	323
1968	14	863
1969	21	1,369
1970	29	2,456
1971	33	2,843
1972	41	6,992
1973	33	4,616
1974	68	8,828
1975	47	13,426
1976	55	8,117
1977	150	[2] 54,860
1978	[3] 170	[2,3] 449,940
1979	19	[2] 5,806
Total	[3] 714	[3] 560,758

[1] 1st termination occurred in 1959. Figures for July 1977 through April 1979 based on notices of termination filed April 1975 through April 1977.

[2] Notice of termination may be withdrawn at any time before the end of the 2-yr notice period.

[3] Of these, 391,500 are employees of New York City comprising 9 coverage groups. New York City's Mayor Beame has announced that the coverage of New York City employees will not be terminated, but to date no official request has been made for withdrawal of the notice of termination.

Senator NELSON. I just want to pursue one question on the issue raised by Mr. Danforth on the question of taxing the income of the employee without increasing the benefits.

Is it not correct that basically social security was founded as an entitlement system. That basically has been the system from the beginning, has it not?

Secretary CALIFANO. That is correct, Mr. Chairman.

Senator NELSON. The argument has been made by many people about increasing the taxes paid without increasing the benefits. Of course, that is an income redistribution plan, is it not? That would change the basic characteristics.

Secretary CALIFANO. That would clearly be an income redistribution plan.

Senator NELSON. Another frequently raised issue is that of people who say, "I would rather not be under the social security plan. I could do better if I managed my own money and invested it for retirement."

I note on the chart on page 8 of the bluebook on "Social Security Financing" that a retiree who retires with an average monthly earning, for purposes of computing his pension, of $400 receives a benefit of 44 percent of the $400 and that when an employee gets to an average monthly income, for purposes of computing his retirement, of $12,075 he or she is receiving 27 percent, as against 44 percent of his final rate of earnings. Is that correct?

Secretary CALIFANO. That is correct.

Senator NELSON. The question that I have never seen addressed, although it may have been, is at what stage does the employee reach a situation at which he is as well off or better off under a private pension plan paid for by himself than he is under social security? Has any computation ever been attempted on that basis?

Mr. CARDWELL. Actuaries and pension planners have addressed this question many times. It is hard to come up with a generalization that will satisfy your question, because there will always be instances where an individual with middle or upper-middle income who is very fortunate in his investments could obtain a return greater than the return he obtains through social security. On the other hand, social security quite clearly is a good buy for the lower income worker.

It also tends to be a good buy for the upper income worker if he has the misfortune to find that his investments did not pay off at the higher return rate.

Bear in mind that if you did not have social security that a lot of workers are going to become dependent upon society and the cost of maintaining them in old age would still have to be borne one way or the other.

Senator NELSON. Certainly in a retrospective study based upon what has happened in the past quarter of a century, actuaries could compute the amounts of money that would have to have been invested in the purchase of a retirement plan and tell us at what stage in the past 25 years an employee would have been better off in his own purchased retirement plan than under social security, recognizing that it may very well be different for a family of six or a

widow or widower or people whose children go to college and therefore are covered up to age 21.

But you can take each of those circumstances in a retrospective study and come up with a figure.

The reason that I raise that is that if you do achieve a point in which there is a redistribution of income program, which may be perfectly all right—I am not arguing the philosophy—I perceive that you would have a tremendous erosion of support for social security by that class of people who are getting less out of the system than they would out of a private system, and if it occurred, at, say, $20,000 or $18,000, you'd have a lot of people involved and you might erode support for the social security system.

Mr. CARDWELL. That point can be analyzed and I think the result would be as you described it if you make the comparison on the basis of an annuity. But if you should examine social security as a form of casualty insurance, rather than solely as an annuity system, which is the more appropriate comparison in my judgment, protecting you against the loss that might or might not occur, just as your fire insurance on your home or your accident insurance on your automobile does.

When you throw in the factor, or include the factor, that social security includes disability benefits, if you become disabled, which most private insurance plans do not do, and if you recognize that social security also provides survivors' benefits for dependents and survivors, it is a good buy. I think that is what most analysts would tell you.

Senator NELSON. Senator Danforth?

Senator DANFORTH. One other question.

Your proposal to shift hospital insurance funds to the rest of the program, is this proposal conditioned on the 9 percent cap?

Secretary CALIFANO. We believe we need the 9 percent cap to do that. We took only $7 billion, basically 70 percent of what we had over that 5-year period, to give us some leeway. I think we would prefer not to do that, and would not want to do that and the actuaries would not, unless we had the hospital cost containment proposal. That goes to the point that some way would have to be found to raise $7 billion.

Senator DANFORTH. Absent some kind of a cap on hospital costs, you withdraw this side of the recommendation?

Secretary CALIFANO. Absent a cap, some other means of controlling costs or meeting them would have to be found.

Senator DANFORTH. Thank you.

Senator NELSON. Senator Hathaway?

Senator HATHAWAY. With regard to the decoupling program, actually it saves 12 percent, but you get 8 percent put in by increasing benefits by the results of the decoupling. Is that correct?

Mr. CARDWELL. We do not follow the question.

Senator HATHAWAY. Decoupling alone, it would save 12 percent, I understand.

Mr. CARDWELL. It would reduce the long term 75-year deficit that is estimated at 8.2 percent of payroll. It would reduce that by half, so the deficit would be about 4 percent.

Senator HATHAWAY. Is that 4 percent computed by taking 12 percent saving by decoupling and adding in 8 percent to take care of the benefit structure which would result by having decoupling?

Mr. CARDWELL. That is arithmetic I do not follow. I am sorry.

Secretary CALIFANO. We would have to answer that for the record.

[The following was subsequently supplied for the record:]

The calculation to which Senator Hathaway refers is shown in table 17 of the Senate Finance Committee print, "Social Security Financing", prepared by the Committee staff, as follows:

Impact of administration proposals on long-range financial status of trust funds

[As percent of taxable payroll]

Deficit under present law	−8.2
Savings from decoupling	+12.0
Cost of wage-indexed benefit formula	−7.9
Effect of:	
Employer base increases	+0.9
Employee base increases	+0.1
Self-employed tax increase	+0.1
Diversion of hospital taxes and acceleration of 2011 tax rate increase	+1.0
Dependency tests	+0.1
Residual deficit	[1] −1.9

[1] While the administration's proposals would assure sufficient financing for the next 25 years or so and maintain the reserve ratio above one-third in the 1980's, they would leave a long-range deficit of 1.9 percent of taxable payroll, which is equal to about 12.6 percent of long range expenditures, under the program as it would be modified by the Administration's recommendations. The administration says that this deficit is to be studied by the Social Security Advisory Council along with other benefit adequacy questions which would change the long range deficit.

This calculation is correct. However, the device of showing a saving from decoupling of 12 percent of payroll and then a 7.9 percent cost for maintaining current replacement rates for future retirees tends to be confusing, since—as is recognized elsewhere in the Committee print—"simple decoupling" without some mechanism for adjusting initial benefits which produces the 12-percent saving is not a viable option, because of the resulting very sharp decline in initial benefits. Since viable decoupling options also address the question of future benefits of current workers, the cost of such provisions is generally included in calculating the net saving from decoupling proposals. Thus, it is generally said that the Administration plan results in reducing costs by 4.1 percent of payroll, rather than by 12 percent with a cost increase of 7.9 percent.

Senator HATHAWAY. My point is, part of that 4 percent savings is a net figure. Your proposal increases benefits by 8 percent. If instead we increase the retirees' benefits by 4 percent, then with decoupling you would take care of the long term deficit because you would be serving a net of 8 percent.

Secretary CALIFANO. If you further trimmed the benefits back.

Senator HATHAWAY. Just the benefits as a result of decoupling.

Secretary CALIFANO. What you have to do, is to reduce benefits below the rates they are at presently. If you do that, you will save even more money by decoupling, if you decouple in that way. We propose to leave benefit levels where they are. We think it is about right, the present benefit rate.

Senator HATHAWAY. The only reason I ask you the question, to put it in perspective, is that if we wanted to reduce the benefit increase amount then we could save an awful lot more by decoupling, in and of itself.

Senator CALIFANO. In the long run; you would still have the 5-year problem.

Senator HATHAWAY. Since the social security tax and the social security trust fund are not like an ordinary pension plan where a person puts in money periodically, accumulates it and the income which is reinvested it is simply a system where we are taxing the people to pay the current benefits. If there is anything left over, we put it in the contingency fund. At the present time, there is nothing left over, so in effect, what we are doing is taxing people today to pay benefits today, which is the same thing we are doing under the Federal income tax.

We are taxing people to pay current expenditures.

So why not take the next logical step and make this a truly progressive tax and just add it onto the Federal income tax and pay the benefits out of general revenues?

Secretary CALIFANO. We thought that we should not go into general revenues for more than a countercyclical touch. We should do that in a way that would not permit permanent benefits to be built into the system as a result of general revenue financing. I guess, in response to the same kind of concerns that Senator Long expressed and in view of the controversy that that very gentle dip of the toe in the water of general revenues has created, I think we are not even ready to go up to the ankle.

Senator HATHAWAY. Senator Long's concern was that to the extent you are going to finance it out of general revenues it is simply increasing the deficit. Unless we add a tax increase to take care of that, we will just increase the deficit.

Secretary CALIFANO. We will not increase the budget deficit unless we have to spend the money. I can submit for the record a letter from the Treasury Department. Hopefully, you would never have to spend that $14 billion.

[The following was subsequently supplied for the record:]

THE DEPARTMENT OF THE TREASURY,
Washington, D.C., May 17, 1977.

Hon. JAMES A. BURKE,
Chairman, Subcommittee on Social Security, House Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to a telephoned call from William Kelley of your staff asking for an explanation of the fiscal effects of the proposed counter-cyclical financing of the social security system from general revenues. The explanation follows.

1. A counter-cyclical payment from thee general fund would be shown in Treasury financial statements as a *budget outlay* (from the general fund) and a *budget receipt* (in the trust fund), with no net effect on the unified surplus or deficit.

2. The trust fund receipt would be invested in special issues of public debt securities. In Treasury statements that would show up as an increase in the *public debt* and an increase in *investments in Federal securities*. Neither side of this entry would affect the budget.

3. Interest accruing on the special debt issues would be paid to the trust fund, resulting in a *budget outlay* (general fund) offset by a *budget receipt* (trust fund).

4. None of the foregoing transactions would affect cash. The cash impact, and the net budget impact, would come only, if the trust fund had to redeem

the investments, or use the interest, in order to pay benefits. In that event, the benefit payment would be a *budget outlay* with a decrease in *cash*.

If you need additional information, we will be happy to supply it.

Sincerely yours,

DAVID MOSSO.

Senator HATHAWAY. My concern is that we add on a tax but meld it into the regular income tax system, making it more progressive and financing the Social Security fund as well. Was that not considered—or was it considered and dropped?

Secretary CALIFANO. We looked at other general revenue alternatives. We looked at an alternative to take one-third from the general revenues, one-third from the employer and one-third from the employee, which Chairman Burke in the House has long proposed. We looked at those and decided to go to the counter cyclical general revenue concept. Our basic feeling was we ought to try to keep the system self-financed. If the economic condition was such in the country that unemployment exceeded 6 percent, it was so bad the Government was in some degree at fault and that was the point at which the whole common pool of the income of society should come into play to some degree. The degree we chose was to pick up the Social Security taxes we had lost because unemployment exceeded 6 percent. When we as a nation are that badly off we think we should come in with general revenues, because it is not a fault of those workers.

Senator HATHAWAY. My point was, since this was just another income tax, why not make that part of the general revenues and do it that way?

Is it your concern that Congress would run away with benefits if it were out of the general fund?

Secretary CALIFANO. Our concern is that we have a viable trust fund system. We ought to try to keep this system as self-financing as we can. We are not ready to go further into the general revenues. I suppose it would be fair to say that we had some of the concern of building more benefits into the system on a permanent basis out of general revenues without coming up with wanting to finance them.

Senator HATHAWAY. Probably I could assume that you did not advocate the Milton Friedman plan, not only financing out of general revenue fund, but tying it in with other so-called poverty programs, ignoring age differential, and just paying out of general revenues for a person, whether he is a 1-year old or 100 years old, whatever he needs to supplement his income?

Cut out those retirees above a certain income level from getting any?

Secretary CALIFANO. That is not the only place where we part company with Milton Friedman, but we certainly do there.

Senator HATHAWAY. Thank you very much.

Senator NELSON. Senator Laxalt?

Senator LAXALT. I have one closing question, Mr. Secretary, a question asking for an explanation—maybe you are the wrong man to ask—that we spent here several weeks ago quite a bit of time looking at an economic stimulus package. Part of that package involves a rebate of Social Security taxes and part to the employers. A few weeks later we were asked to endorse the program that appears to be a complete reversal of that approach.

To me, it appears contradictory and I would like for the record to have some kind of explanation of it, if you could offer it; maybe you are the wrong one.

Secretary CALIFANO. No; I am not. I do not pretend to speak with the economic expertise of Charles Schultze, but we deliberately designed this plan so as not to interfere with the economic stimulus package. We are not taxing the employee. We are not imposing even the increased tax wage base on the employer, until 1979, 1980 and 1981, so the stimulus package can go forward. We think it is very much consistent with the stimulus package and moreover if you do not go with this kind of a plan which saves $38 billion in revenues that otherwise would have to be raised, $14 billion out of the general revenue for the "insurance fund" and the $24 billion that we do not have to have because we can hold the reserve at 35 percent rather than 50 percent with that "insurance fund"; that $38 billion would, we think, create a very serious problem in the context of the economic stimulus package.

Senator NELSON. Senator Byrd?

Senator BYRD. Mr. Secretary, I asked you earlier whether the general fund's contributions to the trust fund today are appropriated annually, and you answered that they are not.

Secretary CALIFANO. Some are and some are not. You corrected me on one which I think was the SMI appropriation. You said it was annually made.

Senator BYRD. The committee staff has checked this out, and I think you were in error. Perhaps you would want to check your records.

Secretary CALIFANO. I will. Thank you.

[The following was subsequently supplied for the record:]

APPROPRIATION OF GENERAL REVENUES TO SOCIAL SECURITY TRUST FUNDS

Under present law, general revenues are used in the social security cash benefits program only to a very limited extent and only to finance benefits in special cases. General revenues are used in the cash benefits program to finance (a) special payments made on a transitional basis to certain uninsured people age 72 and over, (b) benefits attributable to military service before 1957, (c) noncontributory wage credits provided for members of the military service after 1956, and (d) noncontributory wage credits for American citizens of Japanese ancestry interned during World War II.

In addition, general revenues are used in the hospital insurance part of the Medicare program to finance that part of HI costs which are attributable to the military service and internment referred to above and for the provision of HI benefits for certain uninsured persons age 65 and over. Also the supplementary medical insurance part of Medicare receives general revenues as premiums for SMI.

All of the general revenues referred to above as well as general revenues paid to the trust funds as interest on the invested assets of the funds require annual appropriation by the Congress.

Senator BYRD. I just have a couple of questions on another subject. How many employees do you have in the Department of Health, Education, and Welfare?

Secretary CALIFANO. We have approximately 145,000 employees; somewhat less now.

Senator BYRD. How many employees do you have in the congressional liaison?

Secretary CALIFANO. I cannot answer that question off the top of my head. I can submit it for the record.

Senator BYRD. I would like you to submit it for the record.

[The following was subsequently supplied for the record:]

Dan Dozier, Director, Congressional Liaison.
Eleanor Lewis, Deputy Director.
Beverly Mitchell, Special Assistant.
Janet Hill, Secretary (Typing).
Ollie Hanna, Stride Intern.
Otelia Ford, Congressional Liaison Assistant.
Richard DeSeve, Clerk-Typist.
Linda Gangloff, Congressional Liaison Assistant.
Olivia Upshur, Congressional Liaison Assistant.
Ellen Heim, Supervisory Congressional Correspondence Assistant.
William Ellison, Clerk-Typist.
Tijuana Washington, Clerk-Typist.
Mamie Young, Congressional Liaison Assistant.

Senator BYRD. What is the total personnel cost of the Department of Health, Education, and Welfare, including retirement costs?

Secretary CALIFANO. I will have to submit that for the record.

Senator BYRD. I would like to have that submitted for the record.

[The following was subsequently supplied for the record:]

Personnel costs, 1977

Compensation	$2,446,506,000
Benefits	273,548,000
Total	2,720,054,000

Senator BYRD. Do you feel that you have adequate personnel, or do you feel you need additional personnel?

Secretary CALIFANO. Senator, there are some areas, I think that if we had additional personnel in the areas relating to medicaid, medicare fraud and abuse——

Senator BYRD. Administrative personnel. Do you have adequate administrative personnel?

Secretary CALIFANO. I am trying now, in my own immediate office, to reduce the number of administrative personnel. We are shooting hopefully over the course of a year or so to reduce that from 160 down to 100. I think we have reduced it already to 140. It is not as easy to do.

Senator BYRD. The reason I ask, I wrote you on May 6, 1977—this is June 13th—and I followed it up with a telegram on June 2, 1977. I sent you another telegram this morning, which of course you have not had an opportunity to get. I had forgotten you were going to be before the committee. I am very glad you are.

Secretary CALIFANO. I am not sure I am now.

Senator BYRD. I want to read my letter into the record, read it to you and hopefully get some expression from you.

Secretary CALIFANO. If your letter has not been answered it is inexcusable and we will answer that letter within this week.

Senator BYRD. I will read you the letter.

MY DEAR SECRETARY CALIFANO: I have been long concerned over what I feel to be an excessive paperwork burden imposed on local school districts by the Office of Civil Rights within the Office of Health, Education, and Welfare.

A recent announcement in the Federal Register, volume 42, no. 62, Thursday, March 31, 1977, carries that burden to an even more absurd level.

The Office of Civil Rights proposes to require school districts which have just completed forms OS/CR101 and 102 for the 1976–77 academic year to provide the same facts, using the same forms, during the fall of 1977. Assuming that the time required to collect data for the 1976–77 report exceeded 1,000 man-hours for some school districts in the State of Virginia, the requirement that substantially identical statistics be provided for the succeeding year perverts the educational function into a form of paper chase.

Dr. John W. Poltern, President of the Council of Chief State School Officers, indicated last year that "the data burden is excessive, requiring hundreds of thousands of hours of personnel to provide information that we believe goes far beyond what is reasonably necessary to comply with the law."

I concur with this assessment. I would only add that resources expended in completing redundant forms can only result in added costs to the taxpayers and reduced effectiveness of education.

Mr. Secretary, I am asking you to intervene in order to put reasonable limitations on self-defeating paperwork requirements of the paperwork requirements of the Office of Civil Rights. As I stated before, I believe no greater benefit to public education could be provided than to curb this unreasonable demand by the Department of Health, Education, and Welfare.

Now, I might say that when your confirmation hearings were held, the newly elected Senator from Nebraska, Senator Zorinsky, and the newly elected Senator from New Mexico, Senator Smith, made virtually the same statement that I have made. Both of those had just completed many months of campaigning in every section and area of their State, just as I did in the State of Virginia. I find everywhere I go that school officials are deeply and keenly upset with the amount of paperwork that HEW is forcing upon them. It is taking time away from their other activities and taking time away from education which is their prime consideration.

My question to you is, do you propose to require these school districts to again submit these voluminous reports that they have just completed within the last few months?

Secretary CALIFANO. I have reduced those reports or requests to 16,700 school districts, essentially every school district in the country. I have acted first to reduce the school districts that have to comply to about 3,000 to take a sample this year, not to go into every school district in the country, because there is some legitimacy to those complaints about being overburdened. Second, those schools that hurt most are schools with one or two administrative people, the principal, often, who is often teaching a course and has a class.

Senator BYRD. Have you seen those reports that they have to fill out?

Secretary CALIFANO. Oh, yes. Let me tell you what I have done in that area, because I recognize the legitimacy of the complaints. We will provide HEW personnel to fill those forms out for the small schools to ease the administrative burden on them.

Senator BYRD. You are going to have to employ more people to do that.

Secretary CALIFANO. No, we will do it within our existing resources.

Senator BYRD. Then you have too many people, then, if that is the case.

Secretary CALIFANO. Senator, I think we can exert a little extra effort, and get that done. As I said, 3,000 school districts, of which

only a small number will be small, in the kind I described we will help. You are talking about the civil rights paperwork area. I think that one has to remember that there was a day when the Office of Civil Rights in HEW was responsible——

Senator BYRD. We are talking about this year, 1977 and the upcoming season of September 1977.

Secretary CALIFANO. I reduced it from 16,700 to 3,000 and I will provide, as I indicated, to the school officials, provide people for those small schools who do hurt for filling out these forms.

Senator BYRD. It is just not the small schools, the large ones are hurting also. It takes many, many man-hours, 1,000 man-hours it took in some of the systems in Virginia.

In any case, I wish you would give me a detailed answer. I think that is an appropriate and proper thing to do. This letter was dated May 6, 1977. A followup telegram on June 2, 1977.

Secretary CALIFANO. As I say, it is inexcusable that that letter was not answered. It will be answered within this week. We have problems over there, and administratively we will straighten out.

Senator BYRD. I have not known such a problem as this since Bob Finch left. Thank you.

[The following was subsequently supplied for the record:]

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE,
Washington, D.C., June 13, 1977.

The Honorable HARRY F. BYRD, Jr.,
United States Senate,
Washington, D.C.

DEAR SENATOR BYRD: As I indicated during my testimony today, I regret that this Department has not replied to your letter of May 6 or your followup communications.

The Department's current policy and plans with respect to the 101/102 survey of school districts for 1977 and future years are guided by my February 17 statement on this and related civil rights issues, a copy of which I have enclosed for your reference.

The Department's Office for Civil Rights, which conducted the survey, has under review the concerns that you and others in Congress and beyond have raised. I will be in touch with you promptly if our continuing study of these matters leads me to modify the plans set forth in the enclosed statement.

Sincerely,

JOSEPH A. CALIFANO, Jr.

Senator HATHAWAY. Mr. Secretary, has any study been made of the impact of the social security tax on your proposal as was made with respect to Federal income taxes? By that, I mean who actually does pay the tax.

The $30 billion, 48 percent of that is going to be deducted so the general taxpayers are paying that. How much of that 52 percent remaining could be passed onto the consumers? Probably a lot of it, because it will be the large corporations that are paying it.

Secretary CALIFANO. I do not think a large part of that tax has to be passed on to the American consumer. I think in competitive businesses it will not be passed on to the American consumer.

Senator HATHAWAY. According to the FTC there are 200 industries in the country which are essentially noncompetitive. They are going to be paying most of this tax. There is not much hope that we can prevent them from passing it on.

I just wondered if you had such a study for our deliberations in determining the merits of this particular recommendation?

Secretary CALIFANO. We will do that.

Senator HATHAWAY. Thank you.

[The following was subsequently supplied for the record:]

INCIDENCE OF OASDHI TAXES BY INCOME CLASSES

The following table shows OASDHI taxes as a percent of 1976 income for all households. The calculations are based on the assumption that the employer's share of the tax is shifted backward. While there is not complete agreement on the incidence of the employer's share of the tax most economists believe that the employer's share, in the long run, is borne by employees in the form of lower wages.

OASDHI TAXES AS A PERCENT OF INCOME BY HOUSEHOLDS

Income class	Type of household head			
	Aged	Nonaged male	Nonaged female	All heads
Less than 0	0	−2.84	−9.84	−2.89
0 to $999	.36	11.41	6.30	6.88
$1,000 to $2,999	.42	7.98	4.91	3.45
$3,000 to $4,999	.96	8.13	6.50	4.29
$5,000 to $7,999	1.86	10.40	9.49	7.46
$8,000 to $9,999	3.09	11.04	10.49	9.33
$10,000 to $11,999	3.93	11.40	10.52	10.10
$12,000 to $14,999	5.30	11.47	10.20	10.72
$15,000 to $19,999	5.77	10.95	9.93	10.50
$20,000 to $24,999	6.12	10.00	8.91	9.74
$25,000 and over	4.55	7.52	7.32	7.32
All households	37.0	9.38	9.21	8.75

Note: This table does not take account of the earned income tax credit. Aged heads of households are age 65 or older.

Senator NELSON. Mr. Secretary, we have a number of questions that, for purposes of economizing on time, we would submit to your office and ask for a response in writing for the record.

Secretary CALIFANO. We would be delighted.

Senator NELSON. Thank you very much.

[The questions and answers, prepared statement, and charts of Secretary Califano follow. Oral testimony continues on p. 77.]

QUESTIONS SUBMITTED TO SECRETARY CALIFANO AND HIS ANSWERS TO THEM

REPLACEMENT RATE LEVEL

Question. Your wage indexing proposal is based on maintaining replacement rates as opposed to the present law system which has growing replacement rates. If the growth of replacement rates under the present system is a basic flaw, why does your proposal aim to stabilize these rates at 1979 levels, thus picking up several year's worth of that flaw's impact?

Answer. During the development of the Administration's decoupling proposal, we considered stabilizing replacement rates at levels lower than those that prevail at implementation. This approach would both increase the program saving under decoupling and mitigate the effect that recent high rates of increase in the CPI (and relatively low or negative increases in real wages) have had in increasing future replacement rates under the present coupled system. However, we rejected this approach for a number of reasons:

First, it would have adverse effects on the retirement planning of people nearing retirement when the new system is implemented unless the guarantee were set at the 1979 benefit level. However, this would increase transitional costs substantially and would largely offset the early-year saving from providing lower initial replacement rates.

Second, we believe it essential that the decoupling proposal be enacted as soon as possible and have deliberately avoided the inclusion of nonessential and potentially controversial provisions such as lower replacement rates in the decoupling package that could delay enactment. The Administration proposal therefore provides for stabilizing replacement rates at 1979 levels.

The broad question of what social security replacement rates should be is certainly one which deserves serious attention, but it should be dealt with separately from the issue of decoupling. The appropriate level of social security benefits is an issue which will no doubt be addressed by the statutory Advisory Council that is expected to be appointed in the near future.

BENEFIT ADEQUACY

Question. If we are going to be drawing up a new benefit formula, one thing we have to look at is whether it provides adequate benefits. What sort of guidelines can you give us as to what constitutes an adequate social security benefit?

Answer. As you know, there is considerable room for debate on the question of what constitutes "adequacy" in social security benefits. When the social security program was established in 1935, the Finance Committee noted that the benefits were intended to "provide more than merely reasonable subsistence." Since then the Congress has acted periodically to maintain the value of benefits and to make real improvements in benefits. Since 1972, the law has guaranteed that benefits will not be eroded by inflation by providing for automatic adjustment of benefits to keep up with the cost of living.

There is a lack of a widely agreed-upon yardstick for measuring benefit adequacy—one could use the poverty level, or the hypothetical budgets for families and couples prepared by the Bureau of Labor Statistics, for example. We believe that enactment of the President's decoupling proposal will, by stabilizing the benefit structure, permit due consideration of the overall adequacy of social security benefits—an issue which will be addressed by the next Advisory Council.

SPOUSES BENEFITS

Question. We hear a lot about how the social security program is unfair to the wife who works, to the wife who stays at home to care for her family, and to the wife who combines both jobs. Is there anything in your new benefit computation procedures for these women?

Answer. There are no provisions in the Administration's decoupling proposal specifically designed to affect the social security protection of married women. The Administration's proposal for a dependency test for a dependent's benefit would have a direct effect on the protection of married women. Whereas married women have previously been presumed to have been dependent on their husbands, the proposal, which would treat men and women alike in response to the recent Supreme Court decision dealing with equal treatment of male and female dependents, would require women to hereafter establish the fact of their dependency before becoming eligible for a benefit.

In general, however, the present proposals do not directly address the concerns that exist about the impact of social security on married women—working and nonworking. As you know, the treatment of working and nonworking wives is an especially difficult issue to deal with effectively since it involves major questions of equity between single and married workers and between one- and two-worker couples. This question was considered by both the 1971 and 1975 Advisory Councils on Social Security, neither of which found satisfactory ways to provide more equitable treatment in this area without creating inequities or other anomalies in other areas. Nevertheless, we recognize that this is a significant problem area under the program, and we believe that it should be carefully reexamined in the future and in light of the proposals that are now pending. We will be asking the next Advisory Council on Social Security, which is to be appointed this year, to give special attention to the treatment of spouses who work for wages and those who do not and to determine whether satisfactory ways for dealing with this question exist or can be developed.

NEAR-TERM FINANCING

Question. It is getting pretty late in the year for us to act on such a major change in the social security program, particularly if adjournment comes early

in October. Yet we have to act somehow on the short-term financing problem or the disability insurance program will run out of money, perhaps as early as the end of next year. If we don't get the House bill in time to act on the full package this year, what do you recommend as an interim measure to carry through next year?

Answer. Adequate social security financing is of the highest priority with the American people and with the Carter Administration. And we believe that if the Congress also gives this matter such priority it will be possible for it to act to eliminate the near-term financing problems of social security so as to prevent the depletion of the social security trust funds that would otherwise occur.

DEPENDENCY TEST FOR SPOUSE'S BENEFITS

Question. To offset the recent Supreme Court decision, you propose to pay dependent's benefits only to the spouse with the lower income in the 3 years before retirement. Wouldn't it be likely that individuals would tailor their work and retirement decisions in such a way as to be sure they qualify? Wouldn't the simpler approach be to treat primary civil service retirement benefits just like primary social security benefits; that is, to reduce dependent's benefits by the amount of the primary benefit?

Answer. Under our proposal, a worker's spouse or surviving spouse would be considered dependent on the worker for social security benefit purposes if the spouse's or surviving spouse's income in the three years before the worker retired, became disabled, or died, was less than the worker's income in those years.

It is not likely that the kind of "tailoring' mentioned in the question would occur in death and disability cases. It would be possible in some cases for people to tailor their work and retirement decisions in such a way as to be sure that one spouse would be found to be dependent on the other spouse's earnings. Such tailoring," in and of itself, would not necessarily be wrong, of course. It could result, though in some cases, in a finding of dependency that could be considered to be anomalous. However, this same kind of thing can happen under the one-half support test in the present statute, so it is not a new possibility that is being created by the proposed new dependency test. Moreover, one reason the proposed new test would look at the dependency relationship over a 3-year period instead of the 1-year period used in the one-half support test is precisely to reduce the extent to which such tailoring would occur and such anomalous findings result. Also, of course, even in those cases where an anomalous finding did nevertheless occur, the "dual entitlement" provisions of present law would preclude the payment of a spouse's benefit to an individual except to the extent that it exceeds the individual's own social security benefit based on his or her own earnings.

The noncovered pension offset approach would result in far more dependents' benefits being payable than the proposed new dependency test would. Compared to a pension offset approach, the proposed new dependency test would be a much more effective way of providing that social security spouses, and surviving spouses' benefits would be paid in a manner consistent with the dependency basis of those benefits.

HOSPITAL INSURANCE TAX TRANSFER

Question. As I understand it, your proposal to transfer some of the scheduled increases in hospital insurance taxes to the cash-benefits programs depends on Congress enacting your hospital cost containment proposals. If those proposals are not enacted, what alternative financing would you suggest for cash benefits?

Answer. The Administration's hospital cost containment proposals are, of course, important proposals that should be enacted by the Congress on their own merits, without regard to their relationship to the Administration's social security cash benefits financing proposals. At the same time, though, the cost containment proposals do have a significant relationship to the financing proposals. The cost containment proposals help make it possible to shift part of the hospital insurance (HI) tax income to the cash benefits program without adversely affecting the overall long-range financial outlook of the HI program. It is not accurate, though, to characterize the Administration's HI tax transfer proposal as "depending" on Congress enacting the hospital cost containment proposals. It would be accurate to say that if the Congress does not enact the cost of the HI and other health care programs and will have to raise the money that would be saved by enactment of the cost containment proposals.

COUNTERCYCLICAL GENERAL REVENUES

Question. The Administration calls its plan for general revenues for the social security program a "countercyclical" proposal. Isn't the traditional approach of going into a recession with a large enough trust fund to ride it out even more countercyclical? Won't your approach, without increasing outlays, make social security compete for scarce general revenues at exactly the same time we will want to use general revenues for improved jobs programs and other countercyclical measures?

Answer. Although the trust funds should be large enough to ride out a recession without increasing social security taxes paid by employees, employers and the self-employed, the size of the funds does not necessarily govern the extent to which the program may have a "countercyclical" effect. Whenever outgo from the trust funds exceeds current income (as it has since 1975), the securities held by the trust funds are redeemed in order to meet the excess of outgo over income. In redeeming these securities, the necessary monies will be raised either from general tax revenues or by Federal borrowing from other sources. If the deficit in the social security program is to be offset by an equivalent surplus in the general fund, there either will have to be increases in general fund taxes or reductions in other government programs. If the deficit in the social security program is not to be offset by a surplus in general reserves, there will have to be increased borrowing from the public. This situation exists today and would exist in any future year when social security outgo exceeds income.

The Administration's countercyclical proposal, which is temporary, would neither reduce the general tax revenues available for other programs nor require additional Federal borrowing from the private sector. Instead, when unemployment exceeds 6 percent, Federal securities representing countercyclical general revenues would be deposited in the trust funds in order to maintain the funds at an adequate reserve level during recessionary periods and help to avoid any tax increases until economic recovery is well under way. This proposal would have no real economic effect unless these specific securities are redeemed and used to pay current benefits. In this case, of course, the effect would be the same as if other trust fund securities representing social security taxes paid in the past were redeemed to meet benefit payments.

GENERAL REVENUE FINANCING AND SIZE OF TRUST FUND

Question. You propose to calculate the amount of general revenues that would go to the cash-benefits program as it would be calculated by using Okun's law to determine what social security taxes were lost as the result of high unemployment. Robert J. Myers, the former social security actuary, has calculated the actual loss for the years 1975 and 1976 and the loss as it would be calculated under Okun's law. Under Okun's law the amounts were $5.2 billion and $6 billion. Myers, however, calculated the actual loss at $1.8 billion and $1.7 billion. Is his methodology more accurate?

Answer. As you know, Mr. Myers questions the validity of Okun's law in general and its specific application to estimating the loss of taxable payroll and therefore social security tax revenues. His reservations are based in large part on the idea that if taxable payrolls were to increase 3 percent for every 1 percent decrease in the unemployment rate, average wages of all employed workers would be significantly higher. This suggests a basic misunderstanding of the theoretical foundation of Okun's law.

Okun's law recognizes that when unemployment increases, the gross national product (GNP) will be reduced not only because of a loss of employment but also because in a recession hours worked fall and productivity is reduced. The 3-for-1 ratio is a statistical estimate of the total loss of GNP from all factors arising from a 1 percent increase in unemployment. The 3-for-1 relationship may vary as the size of the recession increases and as labor markets (an increase in part-time employment) conditions change. Moreover, the relationship may not strictly hold between employment and taxable wages. To jump from these considerations to Mr. Myers' conclusion that the tax loss is "strictly proportional to

The comparisons that Mr. Myers has made of estimates of revenues that were projected to occur actual revenues that did occur assumed an "other things equal" world which cannot hold true. For example, actual revenues in 1975 departed from projected 1975 revenues (in the 1974 Trustees' Report) not only because of higher-than-anticipated unemployment but also because of higher

inflation (9.1 percent instead of 6.4 percent) and lower productivity (−3.6 percent instead of +2.3). It should be emphasized that it is precisely the decline in productivity during a recession that Okun's law seeks to take account of.

In short, while one might wish to fine tune the 3-for-1 ratio, which might change it marginally, there is no basis for assuming strict proportionality, as Mr. Myers suggests.

LONG-RANGE ACTUARIAL SOUNDNESS

Question. The social security program is said to be soundly financed in the long run if its income is projected to cover its outgo over the next 75 years. Obviously, we cannot expect the predictions of income and outgo to always be in exact balance. What does this Administration consider to be maximum tolerable deficit before you would have to say that you were not in a sound long-range situation?

Answer. When financing provisions are enacted, the goal should be to ensure that the projected income and expenditures are in balance based on the best available economic and actuarial assumptions. Since projections cannot be made on an exact basis, and since expectations about the future are subject to change, over time the program will undoubtedly begin to develop a long-range surplus or deficit. Consequently, there should be an acceptable range within which the program would be considered in actuarial balance. In the past, the program was considered to be within acceptable limits of long range actuarial balance if future income was expected to be within 5 percent of program expenditures over the 75-year valuation period. If the projected deficit exceeded this limit, it was considered desirable to provide for additional financing (or to lower benefits) in order to eliminate the deficit.

The Administration financing proposal was designed to balance income and outgo over the next 25 years and, in fact, over this period the projections show a slight surplus. Many of the proposed financing provisions (and decoupling) have a long-range effect as well; under the 1977 Trustees Report intermediate assumptions, during the second 25-year period (2002–2026) the deficit is reduced to an average of 1.54 percent of taxable payroll and over the third 25-year period (2027–2051) the average deficit is 4.70 percent of payroll. (The deficit over the entire 75-year period is reduced from 8.2 percent of payroll under present law to 1.9 percent under the proposals.)

These remaining deficits are due largely to the anticipated shift in the population age distribution which will occur as a result of the high post-World War II fertility and low current fertility. Considering the distant nature of this problem and the extent to which it is a product of such difficult-to-predict factors as fertility rates and labor force participation rates, hasty action would be ill-advised. Time is available to consider all possibilities, to evaluate emerging demographic trends, and to choose the most effective and equitable methods of bringing income and expenditures into balance over the long range.

SHORT-RANGE GOAL

Question. Apart from the question of general revenues, you have indicated that trust fund equal to half a year's benefit payments is an adequate short-range goal. Formerly it was generally believed that there should be about a full year's benefits in the fund. What is the basis for your conclusion that a smaller fund is now acceptable?

Answer. The purpose of a contingency reserve is to provide a source of funds to assure benefit payments during temporary periods when program outgo exceeds income, such as during a recession, for example. How large a reserve turns out in the end to be needed for this purpose depends of course on how long and how severe the recession is.

The decision as to the appropriate level of trust funds to have for contingency reserve purposes is in large part an arbitrary one. The 1971 Advisory Council on Social Security did recommend a level equal to about one year's expenditures. This seemed a reasonable level and was, incidentally, about the size of the trust funds at the time the recommendation was made. Also, for some time prior to the Council's recommendations long-range cost estimates had been made on the assumption that the reserve would be equal to the following year's outgo at the end of the 75-year valuation period. Nevertheless, the choice was essentially an arbitrary one.

The selection of a proper level for a short-range reserve target is a delicate task. The reserve must be large enough to insure the security of benefits yet small enough to prevent an excessive drain on the economy during its recovery. We think that in the absence of the provision for countercyclical general revenues, which would make a lower level sufficient, a level of 50 percent of a year's outgo would be adequate for the short range because it would be an ample guarantee for benefit payment until the economy recovers further and additional study gives us a clearer idea as to the proper long-range reserve level.

A preliminary study of trust fund adequacy indicated that a level of 50 percent is the minimum level that would have been necessary during the recent recession to prevent the total depletion of the trust funds. As shown in the attached table, a 50-percent reserve level (or a 35-percent level with countercyclical general revenues) would have preserved the trust funds until 1979, by which time unemployment is expected to be below 6 percent.

In the longer run, a higher reserve level might be desirable. However to withdraw money from the economy for the sole purpose of reaching a relatively high reserve level in the near term could seriously impede economic recovery following a recession.

SIMULATED BEHAVIOR OF THE OASDI TRUST FUNDS, 1974–79

[Billions of dollars]

Year	Tax and miscellaneous revenue	General revenues	Interest	Outgo	Ending balance	Reserve ratio [1]
50-percent reserve without counter-cyclical general revenues:						
1973					$30.3	
1974	$59.4		$1.8	$60.6	30.9	50
1975	64.8		1.9	69.2	28.4	45
1976	72.3		1.7	78.2	24.2	36
1977	79.6		1.4	87.7	17.5	28
1978	88.6		1.0	97.5	9.5	18
1979	98.0		.4	107.4	.5	9
35-percent reserve with counter-cyclical general revenues:						
1973					21.2	
1974	59.4		1.3	60.6	21.3	35
1975	64.8		1.3	69.2	18.2	31
1976	72.3	$4.6	1.1	78.2	18.2	23
1977	79.6	3.7	1.1	87.7	14.8	21
1978	88.6	2.6	.8	97.5	9.3	15
1979	98.0	.8	.4	107.4	1.1	9

[1] Reserves at beginning of year as percent of year's outlays.

STATEMENT BY JOSEPH A. CALIFANO, JR., SECRETARY OF HEALTH, EDUCATION, AND WELFARE

Mr. Chairman and members of the subcommittee, during the 1976 election campaign, President Carter promised the American people that, if elected, he would restore the fiscal integrity of the Social Security System.

This morning it is my privilege to testify before this Subcommittee in support of the Administration's Social Security financing proposal which fulfills the President's pledge to the nation. As the President indicated last week, refinancing the Social Security System is one of the top legislative priorities of this Administration.

There is little doubt why this is so. Guaranteeing confidence in the financial structure of Social Security is of vital importance to the 33 million American presently receiving benefits and the 104 million working Americans whose payroll taxes support the system.

As outlined in the Social Security message sent to Congress on May 9th by the President and as detailed further in the 1977 Annual Report submitted by the Board of Trustees of the Social Security System, there are, at present, strong reasons why there has been an erosion of confidence in Social Security's financial stability.

Expenditures from the Social Security Cash Benefits Program have exceeded income since 1975 and will continue to do so unless corrective action is taken. This year alone the income shortfall will be more than $5 billion.

Without changes, the disability insurance (DI) funds will be exhausted by 1979 and the funds supporting the old age and survivors insurance (OASI) program will be completely exhausted by 1983. Only by raising additional revenues can we restore the integrity of programs on which the aged and the disabled depend.

But, as the distinguished members of this Subcommittee know well, even after the short-term financial problems are solved, the cash benefits program would still be plagued by two additional and continuing long-run problems.

First, a faulty mechanism for adjusting benefits for inflation is causing the payments to future retirees to rise more rapidly than their preretirement wages. This is producing unintended benefit increases and driving up costs without providing financing. Eventually, many retirees' benefits will exceed their preretirement earnings.

Second, the recent decline in the birth rate will cause the ratio of beneficiaries to workers to rise in the 21st century, adding dramatically to long-term unfinanced costs.

Over the next 75 years, the deficit in the cash benefit program is estimated to be 8.2 percent of taxable payroll. Payroll taxes would have to almost double starting today in order to finance the benefits that are provided for by present law.

The continuing short and long-term problems are intolerable in programs which provide support to millions of aged and disabled Americans.

The Administration proposals for dealing with these alarming difficulties are comprehensive. They include measures that will eliminate short-range annual deficits, assure full financing through the end of the century, and reduce the long-range deficit to less than 2 percent of payroll.

Devising appropriate solutions has been a difficult and demanding task. But, it is imperative that action be taken now if we are to preserve the Social Security system as we have known it and put that system on a sound financial footing for the rest of this century.

We believe that our package is both reasonable and equitable. In my judgment, it is the only proposal which adequately and responsibly solves the financing problem.

Before our plan was announced, the President and I, and our staffs, carefully reviewed all of the alternatives which were available to us for refinancing Social Security.

Examining these alternatives—and their deficiencies—places the advantages of the President's proposal in sharp relief.

First, there's the quick fix approach; preventing the immediate exhaustion of thee DI trust fund but postponing consideration of the rest of the Social Security financing problem. The quick fix does nothing to reduce the current revenue shortfall in Social Security. We rejected this approach for the following reasons:

> This alternative only serves to postpone making the hard decisions about financing Social Security.
>
> Postponement of remedial action either will make the solution to our present problem more painful or will further jeopardize the soundness of the Social Security System.
>
> Any postponement increases the risk that remedial action cannot be taken in time.
>
> Failure to take comprehensive action now will cause anxiety among older and disabled Americans who want a Social Security System that is secure, not just tomorrow but in the years to come.

Second, there are proposals based on conventional tax increases that do not provide adequate financing.

One such proposal was suggested by former President Ford in his last budget submission. That proposal relied on a phased increase of 0.55 percentage points each in the employee–employer tax rate and a restoration of the traditional relationship ($1\frac{1}{2}$ to 1) between the tax rate paid by the self-employed and that paid by the employed.

As compared to the proposal submitted by President Carter, the Ford plan would have imposed greater tax increases on every category of worker, placing an added burden on many of those who are the least able to pay.

Moreover, under the Ford plan, trust fund reserves at the beginning of 1983 would have equalled only 30 percent of 1983 outlays. We believe this to be an inadequate reserve level under conventional financing mechanisms. Had the OASDI funds held only 30 percent reserves at the beginning of the 1974–75 recession, they would have been exhausted either at the end of this year or early in 1978.

An even less adequate variant of this proposal has been suggested by some business organizations. The new financing contained in this plan comes exclusively from a tax rate increase of 0.3 percentage points on both employers and employees. In addition, under this plan benefits for future retirees would be about ten percent lower than they would be under President Carter's proposal.

Since the tax rate increases in this plan are even smaller than those in the Ford plan, the Social Security reserves produced by this plan are even less adequate. We estimate that under this plan the Social Security system would continue to run annual deficits indefinitely. By the beginning of 1983, reserves would equal only 18 percent of expenditures; by the end of 1986, the trust funds would be exhausted.

We have rejected both of these alternatives because:

They place exclusive reliance on increases in the relatively regressive payroll tax to produce additional revenues—a tax which bites sharply into the paycheck of the average American worker.

They fail to give the Social Security System adequate protection against unforeseen contingencies.

Finally, there is the alternative of using conventional tax increases that do provide adequate financing.

Under traditional methods of Social Security financing, there should be a trust fund reserve in 1983 of 50 percent of expenditures. We base the need for a 50 percent reserve on the behavior of the trust funds during the recent recession. A 50 percent reserve is about the minimum level which would have been sufficient to allow Social Security to weather that recession without running out of money.

Achieving a 50 percent reserve through conventional taxing requires sharp increases in the Social Security earnings base, the payroll tax rate, or both. We estimate that a conventional approach that produced adequate reserves would require additional OASI and DI financing of $80 to $85 billion between 1978 and 1982, and would require roughly twice the payroll tax increase proposed in the Administration plan. Moreover, a standard conventional approach would cost this nation's employers $4 billion more than the proposal suggested by President Carter.

The use of conventional tax increases was rejected, in essence, because:

Increases in the payroll tax rate are regressive; and

Increases in the employee earnings base create large additional long term costs for the Social Security System.

Thus, we strongly believe that all other proposals for financing Social Security advance unacceptable solutions.

We cannot accept a proposal which results in inadequate trust fund reserves.

We cannot accept a proposal which raises revenues by taxing those least able to pay.

We cannot accept a proposal which does not ensure on a long-term basis that America's senior citizens will receive the benefits to which they are entitled.

The President's plan not only restores the financial integrity of the Social Security System, but does so in a manner which costs employers and employees billions of dollars less than any other responsible alternative.

THE PRESIDENT'S PROPOSAL: SHORT TERM FINANCING

Our short-range financing plan would provide the $83 billion that will be required for the cash benefits program between now and 1982 through the following six measures:

The temporary use of counter-cyclical general revenue to be deposited in the OASDI and Hospital Insurance trust funds. This measure, retro-

active to 1975, would produce additional revenues of $14.1 billion by 1982. In addition, we calculate that, with the counter-cyclical general revenue mechanism, reserves equal to 35 percent of expenditures provide the same protection against recessions as would reserves of 50 percent without the counter-cyclical device. By avoiding the need to rebuild reserve levels to 50 percent of expenditures, the use of the counter-cyclical device removes the need to raise $24 billion in new taxes. The counter-cyclical device thereby reduces the new financing needed from $83 billion to $59 billion and together with the $14.1 billion in revenues produced, reduces the financing needed from other sources, to $45 billion.

The removal, in three stages (1979, 1980, 1981), of the ceiling on the amount of an individual's wage or salary on which the employer pays Social Security taxes. This measure would produce additional revenues of $30.4 billion by 1982.

The restoration of the OASDI tax rate for the self-employed to the traditional level of one and one-half times the rate for employees. This measure would produce additional revenues of $1.2 billion by 1982.

An increase in the employee wage base in addition to the automatic adjustments under present law. The increase would be $600 in each of four future years: 1979, 1981, 1983, and 1985. This measure would produce additional revenues of $3.5 billion by 1982, and also provide future increases in benefits.

The shifting of tax rates now scheduled in present law between the OASI program, the DI program, and the HI program, to avoid the exhaustion of the DI trust fund and to provide additional funds for OASI.

The institution of a new eligibility test to determine whether an individual may receive dependents' benefits, to conform to Supreme Court decisions requiring equal treatment of men and women. This measure would reduce expenditures by $2.6 billion by 1982. We propose, in addition, to do away with distinctions based on sex which appear in several other provisions of the Social Security Act.

In the short run, these proposed changes would achieve the following benefits:

They would prevent the exhaustion of the disability insurance trust fund which would otherwise occur in 1979.

They would prevent the exhaustion of the old-age and survivors insurance trust fund which would otherwise occur in 1983.

They would avoid any increases beyond the ones already legislated for 1978 and 1981 in the tax rates on employees' earnings.

They would achieve adequate balances in the trust funds by the end of 1982.

The following table illustrates the means by which our short-term proposals will generate the funds needed to prevent the depletion of OASDI.

Shortrun financing proposals, social security cash benefit programs

[1978–82 aggregates excluding interest earnings]

	Billions
Additional financing needed under conventional payroll tax approach	83
Sources of new financing under administration proposal:	
Countercyclical general revenues:	
Additional revenues produced [1]	14. 1
Savings from lower reserve ratio	24. 1
Tax employer on full earnings of employee [1] (phased in over 3 years)	30. 4
1,200 increase in employee earnings base ($600 in 1979 and $600 in 1981)[1]	3. 5
Shift of medicare tax rate	7. 2
Increase in self-employment tax rate	1. 2
New eligibility test for dependents' benefits	2. 6
Total new financing provided	83

[1] Includes new revenues initially going to hospital insurance (HI) fund but reallocated to cash benefit funds through transfers of the HI tax rate.

The first two recommendations for dealing with the short-term financial problems outlined above are crucial elements of the Administration's plan. Questions have been raised about them, and they warrant discussion in greater detail.

FINANCING FROM GENERAL REVENUES DURING TIMES OF HIGH UNEMPLOYMENT

The proposed new countercyclical financing mechanism is designed to compensate the Social Security System for tax receipts that have been lost as the result of an unemployment rate in excess of 6 percent. An amount equal to the difference between the Social Security taxes that were actually paid and those that would have been collected for the year if unemployment had been no more than 6 percent would be transferred from general Treasury revenues to the Social Security trust funds.

Under this proposal, the transfers would cover the taxes that have been lost because of high unemployment starting in 1975. The transfers would actually be made in 1978, 1979, and 1980, but would reflect the revenue shortfalls of the years 1975–78. Unemployment is expected to fall below 6 percent in 1979.

Using general revenues to make up Social Security taxes lost because of recessions avoids raising the taxes during a recession—an action that would delay economic recovery. Because the Social Security trust funds would be protected against the risk of losing income during times of high unemployment, this special financing device will also make it possible safely to maintain a lower reserve level of 35 percent in the trust funds.

The traditional argument that financing Social Security out of general revenues creates a temptation to raise benefits to excessive levels does not apply to this limited form of general-revenue financing. First, the general-revenue funding would be available only for those years in which unemployment exceeded 6 percent, and thus could not be used to finance permanent higher benefit levels. Second, the amount of general-revenue financing would not be open-ended because it would be fixed by a formula.

In addition, the use of countercyclical revenues has no immediate effect on either the economy or the budget deficit because the general-revenue payment would not be spent during that period but would only be used to increase the level of reserves.

Such a mechanism, while innovative, is nonetheless a fiscally prudent method for helping to guarantee the future of OASDI. Because it is a change from past practice, however, we recommend this proposal as only a temporary measure. We will ask the 1977–1978 Social Security Advisory Council to study whether countercyclical general revenue financing should be made a permanent feature of the Social Security System.

TAXING EMPLOYERS ON THE ENTIRE EARNINGS OF EMPLOYEES

At present, both the employer and the employee pay Social Security tax only on the first $16,500 of the employee's earnings, a figure that under current law, would rise in stages to $23,400 by 1982.

Our proposal would eliminate the ceiling on the earnings on which employers pay Social Security taxes (usually called the "wage base") in three annual steps. The base would be increased to $23,400 in 1979, to $37,500 in 1980, and to the entire amount of wage or salary paid in 1981.

Increasing the amount of earnings on which the employer is subject to tax brings vitally needed additional revenues into the Social Security trust funds without requiring an increase in benefit levels since benefit levels are tied to the wages on which the worker must pay Social Security taxes.

The increased cost to employers—a total of $30.4 billion in the 4 years 1979–82—is, as noted, about $4 billion less than they would pay under conventional Social Security tax-increase plans in which both tax rates and the earnings base would be increased.

This proposal effectively increases from 87.8 percent to 100 percent the proportion of the nation's Social Security payroll subject to employer taxes—an increase in employer Social Security tax liability of about 13.9 percent. Of course, under a conventional financing plan the increase in the employer Social Security tax liability would have been greater—over 15 percent by 1982.

With respect to the last point, it is important to stress that for the vast number of small businesses who have few, if any, workers earning more than $16,500—the President's proposal will have little or no effect on their Social Security tax. The truly small business and business person—the corner grocer, the shoe store, the drug store, the gas station, the small town clothing and gift store, the dry cleaner—are already paying tax on 100 percent of payroll.

OTHER IMPLICATIONS OF THE ADMINISTRATION SHORT TERM PROPOSALS

Our plan would restore the financial integrity of the Social Security System and the faith of the people in the viability of that system. The table below indicates that under the present system, the OASDI trust funds would have deficits in every year, rising to a level of $14.9 billion in 1982—only 5 years from now. Under the President's plan, annual deficits would be eliminated by 1978. Our reserve balances would be built up to $53.6 billion by the end of 1982, establishing a reserve ratio of 35 percent as the countercyclical general revenue approach requires.

STATUS OF THE SOCIAL SECURITY TRUST FUNDS—RECENT HISTORY AND PROJECTIONS OF CURRENT LAW USING PROPOSED 1977 TRUSTEES REPORT ASSUMPTIONS

Year	Old-Age, Survivors, and Disability Insurance, Combined				
	Combined tax rate, percent	Earnings base	Change in trust funds (billions)	Ending trust fund balance (billions)	Beginning reserve ratio [1]
Historical:					
1974	9.9	$13,200	+$1.5	$45.9	73
1975	9.9	14,100	−1.5	44.3	66
1976	9.9	15,300	−3.2	41.1	57
Projected under the present system:					
1977	9.9	16,500	−5.6	35.5	47
1978	9.9	17,700	−6.9	28.6	36
1979	9.9	18,900	−7.9	20.7	27
1980	9.9	20,400	−9.1	11.6	18
1981	9.9	21,900	−11.5	.1	9
1982	9.9	23,400	−14.9	−14.8	0
Projected under the administration's proposed OASDI financing plan:					
1977	9.9	16,500	−5.6	35.5	47
1978	[2] 10.1	17,700	+.6	36.1	36
1979	10.1	[3 4] 19,500	+1.4	37.6	34
1980	10.1	21,000	+3.9	41.5	32
1981	[2] 10.3	[4 5] 23,100	+6.1	47.6	32
1982	10.3	24,600	+6.0	53.6	34
1983					36

[1] Beginning of year balance as a percent of year's expenditures.
[2] Increase due to reallocation of 0.2 percentage points of hospital insurance tax rate.
[3] Elimination of employer's earnings base phases in beginning in 1979. Earnings base for employee would have been $18,900 without ad hoc increase.
[4] Plus $600 ad hoc base increase.
[5] Earnings base for employees would have been $22,500 without ad hoc increase.

Note: Projections based on intermediate assumptions for 1977 trustees report.

Moreover, our proposal would accomplish this without increases in already scheduled future tax rates and with minimum economic impact and disruption of the present recovery. Thus, the Administration's short-term proposals have the following additional advantages:

Use of countercyclical general revenues has, in itself, no immediate economic or budgetary effect.

Countercyclical general revenues would have little inflationary impact since the mechanism would not affect budget outlays.

Eliminating the employer's wage base does not conflict with current efforts to reduce unemployment levels since it would not increase taxes paid for any new or old workers earning less than the maximum. The conventional approach, it should be noted, would have increased those taxes.

Eliminating the employer wage base over a 3-year period will allow the impact to be absorbed gradually and thereby mitigate further any limited short-term inflationary impact.

INTERMEDIATE- AND LONG-TERM FINANCING

Even with the short-term changes contained in the Administration's proposal, Social Security will, as noted above, be significantly underfinanced in the long run. Our long-term proposals both assure the operation of the Social Security program well into the next century and do not impose an undue tax burden on any particular segment of society.

Specifically, we recommend:

Advancing the planned OASDI tax rate increase from 2011 to 1985 and 1990

This tax increase, which is scheduled for 2011 and which amounts to one percent each on employer and employee, would be moved forward. One-quarter of the increase would be imposed in 1985 and the remaining three-quarters in 1990. By adjusting the timing of this tax rate increase which is already contained in current law, we are able to ensure the soundness of the Social Security trust funds up to the year 2000, solving a financial problem which would otherwise develop in the mid-1980's. The system would be actuarially sound—in balance—for the next 25 years. In addition, by accelerating these tax increases we would reduce the long-term deficit by 0.6 percent of taxable payroll.

Decoupling to correct the inflation overadjustment

The flaw in the present automatic-adjustment provisions is one of the principal causes of the projected long-run Social Security financing deficit. Under the Social Security benefit formula written into law in 1972 an unintended escalation in benefit levels for future retirees exists that is generally referred to as overindexing for inflation.

Under the present system, future benefit amounts are affected by increases in the Consumer Price Index as well as incerases in the worker's earnings. This coupled approach to determining future benefit amounts tends to overadjust for inflation and, as a result, the initial benefit amounts for future retirees will rise faster than the wages on which they are based. Thus replacement rates—Social Security benefits as a percentage of final-year earnings—will rise in the future. If this situation is not corrected, many future retirees would get benefits that exceed their highest preretirement earnings.

We recommend that the present "coupled" benefit structure be "decoupled" in a way that would stabilize replacement rates at roughly current levels. The computation of initial benefit amounts for workers retiring in the future would be separated from the automatic adjustment of benefit levels based on increases in the Consumer Price Index for people already on the rolls. Replacement rates will remain stable at today's levels; workers, therefore, will continue to share in the growth of our economy.

The decoupling proposal which I have presented will reduce the projected net 75-year deficit by almost half. Together with the rest of our package, the long-term deficit will be reduced from 8.2 percent of taxable payroll to 1.9 percent. It will also ensure both current and future retirees that the annual cost of living increases authorized in present law will continue undisturbed and that the benefit amounts that future retirees receive reflect the increase in the standard of living that occurs during their working lifetime. In addition to the proposals I have outlined, we will ask the 1977–1978 Social Security Advisory Council to consider the full range of structural and substantive questions that face Social Security.

Finally, together with the hospital cost-containment program which we have already presented to the Congress our Social Security program will also assure the financial integrity of the hospital insurance trust fund in the short run. The cost containment legislation is thus an important piece in the new financial structure we are proposing for the Social Security System.

THE IMPACT

The President's proposal restores the financial integrity of the Social Security System by building reserves back to acceptable levels. In order to achieve the same goal, the conventional approach—increasing the tax rate and the taxable wage base—would increase the tax burden even more on nearly every segment of society.

As compared to the conventional approach, the President's proposal costs low-income workers—those earning the minimum wage—over $40 less a year by 1982.

The self-employed individual earning at the maximum level would pay over the next five years $2,185 less under the President's plan than under a conventional financing plan.

Professionals—higher income workers—also stand to save if the President's plan rather than a conventional approach is adopted—paying at least $587 a year less by 1982.

As I stated earlier, employers in general, while bearing a $30 billion cost under our proposal, would have been faced with an even higher burden—$34 billion—under the conventional approach.

Obviously, the precise differences in effect between our proposal and an adequate conventional alternative varies from one employer to another. For instance, the increased burden under our proposal is significantly smaller than that under the conventional alternative for all firms engaged in retail trade, hospitals, most educational institutions, and state and local government in general. The burden under our proposal is somewhat larger than the burden of the conventional alternative for wholesale trade and certain service firms.

Our proposal also imposes less of an increase on the smaller firms in most industries than does the conventional alternative. For firms employing fewer than a thousand workers, our proposal involves a smaller increase than a conventional approach. This is true in agriculture, forestry and fisheries, mining and manufacturing, construction, transportation, communication, public utilities, retail trade, among nonprofit institutions, and in government.

In some cases, the differences are quite dramatic. We estimate that under the Carter proposal the taxes paid by small state and local government units would increase by 2.5 percent, but under a conventional financing alternative such taxes would increase 10.5 percent.

Among smaller hospitals, taxes would increase 2.7 percent under the President's proposal, but under a conventional financing alternative comparable taxes would increase 10 percent.

In agriculture, taxes would increase 4.8 percent under the President's proposal, but under a conventional financing alternative similar taxes would rise 11.5 percent.

In retail trade, taxes would increase 9.8 percent under the President's proposal, but under a conventional financing alternative comparable taxes would increase 12.4 percent.

For more than four decades, the social security system has been one of the great successes of American government, protecting the old, the infirm, and the needy. That success—which is now a basic element of the lives of millions of Americans—must be continued. The proposals presented to you today will reverse the period of adversity into which the system has fallen and restore it to its proper place—a Government program upon which all our citizens can rely.

Mr. Chairman, the President has meticulously kept his pledge to the American people that he would propose legislation that would restore the fiscal integrity of the social security system without imposing undue burdens on those least able to bear them.

The administration looks forward to working with you, and with members of your distinguished subcommittee, as you begin the critical task of considering much needed reforms in the social security system.

Thank you very much.

OVERVIEW
SOCIAL SECURITY PROGRAMS
(1977)

	BENEFICIARIES	PAYMENTS
CASH BENEFITS		
OLD-AGE AND SURVIVORS INSURANCE (OASI)		
Cash benefits to retired workers and to survivors of deceased workers	28,600,000	$73.3 bil.
DISABILITY INSURANCE (DI)		
Cash benefits to disabled workers and dependents	4,800,000	$11.5 bil.
	33,400,000	$84.8 bil.
MEDICARE		
HOSPITAL INSURANCE (HI) and SUPPLEMENTAL MEDICAL INSURANCE (SMI)	25,100,000	$22.2 bil.

SOCIAL SECURITY FINANCING

PRINCIPLES

- Pay-as-you-go Financing
  - —Ordinarily, each year's revenues finance that year's benefits
- Trust funds serve as contingency reserves

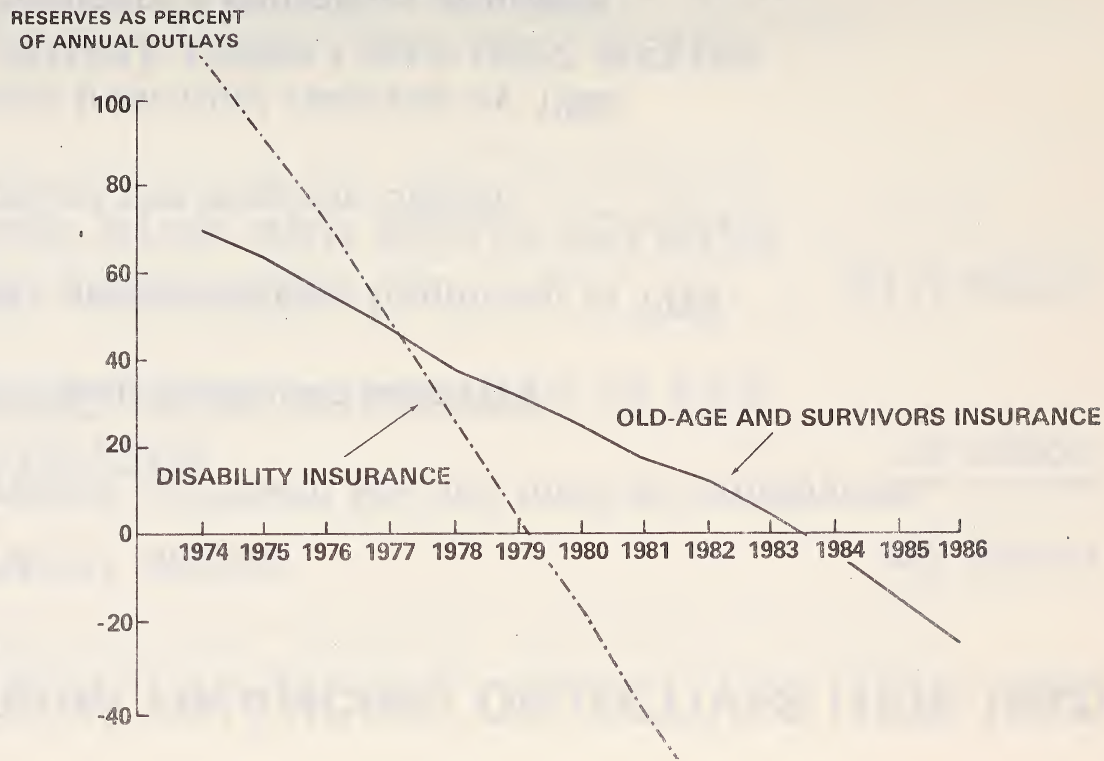
PROCEDURE

- Four separate trust funds
- OASI, DI, and HI financed through separate earmarked payroll taxes
- SMI financed by monthly premiums and general revenues

SHORT-TERM FINANCING PROBLEMS

- Annual deficits in cash programs since 1975, deficits projected to continue
  - —DI trust fund exhausted in 1979
  - —OASI trust fund exhausted in 1983
- Additional revenue needed now in OASI and DI
  - —to end deficits
  - —to maintain trust funds at a sound reserve level

SOCIAL SECURITY TRUST FUND RESERVES UNDER CURRENT LAW



SHORT–TERM FINANCING OBJECTIVES (1978-1982)

—No increases in present law tax rates on employees

—Do not impair economic recovery

—Eliminate annual deficits beginning in 1978

—Help reduce the long-run deficit

—Adequate trust fund reserves by 1982

—Fulfill President's campaign promises

SHORT-TERM (1978-1982) NEEDS

OASDHI NEEDS OVER AND ABOVE REVENUE FROM 1977 TAX RATES	$117 billion
LESS: REVENUE FROM SCHEDULED HI TAX RATE INCREASES	-34 billion
EQUALS: OASDI NEEDS	$83 billion

APPROACHES REJECTED

1. "QUICK-FIX"
2. TAX RATE INCREASES PRODUCING INADEQUATE RESERVES
3. CONVENTIONAL PLAN WITH ADEQUATE RESERVES

"QUICK-FIX"

- SHIFTS PRESENT REVENUES AMONG TRUST FUNDS
- POSTPONES DECISIONS ON NEW FINANCING FOR ONLY A FEW YEARS
- MAKES FUTURE FINANCING CHOICES MORE DIFFICULT
- ENDANGERS SOCIAL SECURITY BENEFIT PAYMENTS

TAX RATE INCREASES PRODUCING INADEQUATE RESERVES

- RELIES ENTIRELY ON REGRESSIVE TAX RATE INCREASES
  - —0.55 PERCENT FOR EMPLOYEES AND EMPLOYERS UNDER 1977 FORD ADMINISTRATION PLAN
  - —0.30 PERCENT EACH UNDER ALTERNATIVE PLAN
- PRODUCES INADEQUATE RESERVE LEVELS

  BY 1983, RESERVES WOULD BE
  - —30% OF OUTLAYS UNDER 1977 FORD PLAN
  - —18% OF OUTLAYS UNDER ALTERNATIVE
- IN LAST RECESSION OASDI TRUST FUNDS WOULD HAVE RUN OUT
  - —IN ABOUT 48 MONTHS WITH 30% RESERVES
  - —IN ABOUT 36 MONTHS WITH 18% RESERVES

CONVENTIONAL PLAN WITH ADEQUATE RESERVES

- EMPLOYS MIXTURE OF RATE AND BASE INCREASES
- TAKES $38 BILLION FROM ECONOMY
- INCREASES TAXES ON EMPLOYEES BY $31 BILLION MORE THAN ADMINISTRATION PLAN
- INCREASES TAXES ON EMPLOYERS BY $4 BILLION MORE THAN ADMINISTRATION PLAN
- INCREASES TAXES ON SELF-EMPLOYED BY $3 BILLION MORE THAN ADMINISTRATION PLAN

SHORT-RUN (1978-1982) FINANCING PLAN

OASDI NEEDS		$ 83 bil.
MEETING OASDI NEEDS		
COUNTERCYCLICAL GENERAL REVENUES		
—Additional revenues produced	$ 14 bil.	
—Savings from lower reserve requirements	24	
TAX EMPLOYER ON FULL EARNINGS OF EMPLOYEE	30	
$1200 INCREASE IN EMPLOYEE EARNINGS BASE	4	
SHIFT HI TAX RATE TO CASH BENEFITS	7	
INCREASE SELF-EMPLOYMENT TAX RATE	1	
NEW ELIGIBILITY TEST FOR DEPENDENTS' BENEFITS	3	
TOTAL NEW FINANCING PROVIDED		$ 83 bil.

ALTERNATIVE TAX RATES AND EARNINGS BASES

	1977	1978	1979	1980	1981	1982
CURRENT LAW						
RATE	5.85%	6.05%	6.05%	6.05%	6.30%	6.30%
BASE	$16,500	$17,700	$18,900	$20,400	$21,900	$23,400
ADMINISTRATION PLAN						
RATE	5.85%	6.05%	6.05%	6.05%	6.30%	6.30%
BASE	$16,500	$17,700	$19,500	$21,000	$23,100	$24,600
CONVENTIONAL RATE/BASE FINANCING PLAN						
RATE	5.85%	6.05%	6.45%	6.45%	6.85%	6.85%
BASE	$16,500	$17,700	$21,300	$23,100	$29,100	$31,200

TAXES PAID BY WORKERS
UNDER ALTERNATIVE FINANCING PLANS

(dollars)

	1978	1979	1980	1981	1982
WORKER EARNING AVERAGE WAGE					
Wage	10,873	11,721	12,553	13,357	14,125
Tax payment: Present law	658	709	759	841	890
Increase: Administration plan	0	0	0	0	0
Increase: Conventional plan	0	47	50	74	77
WORKER EARNING MORE THAN MAXIMUM					
Tax payment: Present law	1,071	1,143	1,234	1,380	1,474
Increase: Administration plan	0	36	36	76	76
Increase: Conventional plan	0	230	256	613	663

ADDITIONAL REVENUE FROM EMPLOYERS

	Conventional Plan	Administration Plan
1979	$ 5.3 bil.	$ 2.6 bil.
1980	6.3	6.1
1981	10.7	10.3
1982	11.9	11.4
TOTAL	$ 34.2 bil.	$ 30.4 bil.

LONG-TERM FINANCING PROBLEMS

- 75-year deficit equal to 8.2 percent of payroll
- Almost half of deficit due to faulty method of adjusting benefits for inflation
  - —Need to decouple
- Rest of deficit due to shifting age of population
  - —Three workers per retiree now
  - —Two workers per retiree in 2030

NEED FOR DECOUPLING

- Retirees' benefits adjusted by increases in the consumer price index (CPI)
- Same CPI adjustment also made to future benefits of workers
- Workers' wages rise with inflation, further increasing their future benefits
- Result is that future benefits increase more rapidly than wages of workers

BENEFIT ADJUSTMENTS FOR RETIREES AND WORKERS MUST BE SEPARATED—"DECOUPLED"

NEED FOR DECOUPLING

	WAGE		BENEFIT FORMULA		BENEFIT
Initial Computation	$10,000	x	.400	=	$4,000
After Inflation Adjustment (6% Inflation)	$10,000	x	.424	=	$4,240
After Wage Increase	$10,600	x	.424	=	$4,494

BENEFIT ADJUSTMENTS FOR RETIREES AND WORKERS MUST BE SEPARATED—"DECOUPLED"

ADDITIONAL FEATURES OF ADMINISTRATION PLAN

- **FURTHER ACTION IS REQUIRED TO**
  —Bring the cash benefit programs into financial balance through at least the year 2000
  —Reduce the remaining long-term deficit to manageable proportions
- **ADMINISTRATION PLAN:**
  —Fully fund the program through the turn of the century and reduce the long-run deficit, by moving scheduled tax rate increase from 2011 to 1990 and 1985
  —Ask the 1978 Social Security Advisory Council to recommend action for dealing with the reduced long-term deficit that remains

EFFECT OF ADMINISTRATION PLAN ON MEDIUM-RUN (1977-2002) DEFICIT

25-year deficit under present law	−2.3%
Effect of short-run financing plan	+1.3
Effect of decoupling plan	+0.4
Effect of tax rate shift	+1.1
Resulting 25-year surplus	+0.5%

EFFECT OF PLAN ON LONG-RUN (1977-2051) DEFICIT

Long-run deficit under present law	- 8.2%
Effect of short-run financing plan	+ 1.7
Effect of decoupling plan	+ 4.0
Effect of tax rate shift	+ 0.6
Deficit remaining	- 1.9%

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THIS PLAN FULFILLS THE PRESIDENT'S CAMPAIGN PROMISES

IT RESTORES SOCIAL SECURITY TO A SOUND FINANCIAL POSITION BY:

—Solving the short-term problem without a tax rate increase.

—Bringing the cash benefit programs into actuarial balance through the turn of the century.

—Reducing the long-term deficit to manageable proportions without reducing the benefits of future retirees.

[Thereupon, at 12:45 p.m. the subcommittee recessed to reconvene Thursday, June 16, 1977, at 10 a.m.]

SOCIAL SECURITY FINANCING PROPOSALS

THURSDAY, JUNE 16, 1977

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY,
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:10 a.m. in room 2221, Dirksen Senate Office Building, Hon. Gaylord Nelson (chairman of the subcommittee) presiding.

Present: Senators Byrd, Jr., of Virginia, Nelson, Curtis and Danforth.

Senator NELSON. Today, the Senate Finance Subcommittee on Social Security holds its second day of hearings on proposals to resolve the immediate and long-term financing problems of the social security system.

Last Monday, Secretary of Health, Education, and Welfare Joseph Califano testified in support of the administration's social security financing proposals. In the subsequent hearings now scheduled by the subcommittee, the panel will be soliciting the advice of social security experts, economists and public and private interest groups. Each of these individuals or groups has a special knowledge of the social security system and their testimony will be helpful to the subcommittee in consideration of the social security system's financial problems.

The subcommittee welcomes today three expert witnesses on the social security system: Mr. Wilbur Cohen, former Secretary of Health, Education, and Welfare and currently dean, School of Education, University of Michigan: Mr. Robert Ball, former Commissioner of Social Security and currently senior scholar at the Institute of Medicine, National Academy of Sciences; and Rita Ricardo Campbell, senior fellow, Hoover Institution on War, Revolution, and Peace, Stanford University and a former member of the Social Security Advisory Council.

Our first witness this morning will be Mr. Wilbur Cohen.

Senator CURTIS. Mr. Chairman, I would like to have the record show that the ranking minority member, Senator Laxalt, wanted to be here for this testimony but he has to preside over the Senate, which is now in session, and he wanted the record to so show.

Senator NELSON. The committee is very pleased to welcome you this morning, Mr. Cohen—not only because of your expertise in this field—we always like to have the benefit of the great knowledge of anybody who comes from the State of Wisconsin.

STATEMENT OF WILBUR J. COHEN, FORMER SECRETARY OF HEALTH, EDUCATION, AND WELFARE AND DEAN, SCHOOL OF EDUCATION, UNIVERSITY OF MICHIGAN

Mr. COHEN. Thank you, Senator Nelson. I am glad to be here in the same room and table again, and particularly to see my good friend, Senator Curtis, whom I have appeared before on numerous occasions and I am always delighted by his careful cross-examination of me in the past.

Senator CURTIS. You are not suggesting that we are having a rematch?

Mr. COHEN. I am willing, Senator. I rather expected it. May I say you have always asked me very penetrating questions. I will be glad to try again today.

Perhaps, Senator, in order to save your time, if you wish you may put my full statement in the record. I will be glad to summarize it so that you could save time, or read it in its entirety.

Senator NELSON. Proceed however you wish. Your statement will be printed in full in the record. If you wish to speak extemporaneously to the points that you consider of greatest importance and discuss them, fine.

Mr. COHEN. If you will put it in the record, I will go over it. If any members of the committee want to ask me about anything that I have skipped over, I would be pleased to do so.

Social security has become an institution which has widespread support. In an era of skepticism, doubt, and criticism of Government programs and policies, it should be heartening for Members of Congress to know of the general acceptance which their efforts over the past 42 years have wrought.

Our responsibility today is to maintain and preserve public confidence in the program and to locate the necessary revenues to assure the program's financial soundness. The Congress acts as the board of directors of this vast system.

Over the years, it has acted in a responsible manner to maintain a financially sound and acceptable benefit program. You are in a position to extend that excellent performance record this year.

Senator NELSON. The point that you made about insuring the integrity of the fund so that those who retire will receive the benefits that they are entitled to is, in my judgment—and I think probably the judgment of everybody in the Congress—the most important part of the exercise in which we are engaged.

All of us know from comments that have been made by those who are covered by the system and those who have retired under the social security system that there is great concern in the country about the integrity and security of that fund. I think the most important aspect of what the Congress is addressing itself to is that aspect of assuring the public and guaranteeing that fund. And, in my judgment, there is no doubt at all that the appropriate taxes and funds will be raised, from one source or another, to assure those who are retired and those who are going to retire that sufficient money will be there to pay retirement benefits.

Although there may be, and is, all kinds of disagreement about what is the best approach, everyone is in agreement—the administra-

tion, the Congress, and everybody else who is concerned about the system—that we must assure that the funds will be there.

I am satisfied that there is no doubt whatsoever that Congress will guarantee that the money will be there. We may reach a resolution of compromise about where they come from, but the funds, in my judgment, are going to be there.

Mr. COHEN. I might say, Senator, that I associate myself fully with your statement and over the past 2 or 3 years when there has been a lot of talk about bankruptcy, or the alleged future bankruptcy of this system, I have made publicly the exact same statements.

A number of former Secretaries and Commissioners have, a couple of years ago, issued a public statement to that effect, and I want to also say—and I am very happy to say it while my friend Senator Curtis is here—irrespective of who has been chairman of the Finance Committee or the Ways and Means Committee, irrespective of what political party has been in power, in my 42 years of association with this program since the beginning there has always been a great sense of responsibility on the part of the members of these two committees about assuring the financial integrity and soundness of the system.

I know of no partisan political effort that has ever been made in these 42 years that in any way attempted to violate the financial integrity of the system. I think that is a very commendable historical fact and one which I hope, and I know, will be continued.

Social security presently involves current disbursements of over $80 billion annually, 33 million beneficiaries, 100 million individual contributors, and over 5 million business enterprises. In the long run, everyone in the Nation is affected by social security contributions and benefits.

I strongly support the general thrust of the President's proposals. However, there are other alternatives to achieve the same overall result of restoring the financial integrity of the system. There are advantages and disadvantages of every method of increasing revenues to the system. The weighing of these advantages and disadvantages involves not only economic and fiscal considerations—including the incidence of taxation—but social psychology as well.

I do not think it is possible to make decisions on these complex factors as they could be made on some scientific basis.

The most important criteria in determining the measures to be adopted is that the general public and the media should be persuaded that the congressional decisions assure the financial integrity of the system and that there is an equitable sharing of the costs. There is a "conventional wisdom" about the concepts of financial integrity and equity in relation to both the contributions and benefits of the system which is shared by the general public which is substantially different than the views expressed by Milton Friedman and economists from the Brookings Institution and elsewhere. While I believe full and thoughtful consideration should be given to the views of macroeconomists, I believe the Congress should be guided by balancing all the factors involved.

President Carter's recommendations for restoring the financial integrity of the social security system are important, responsible, and urgently needed. His proposals will produce: (1) additional income to the social security system over the next 5 years; (2) provide addi-

tional income to the system beginning in 1985; and (3) eliminate the flaw in indexing for inflation enacted in the 1972 amendments which will reduce the longrun cost by about 4 percent of payrolls.

When enacted, as I hope they promptly will be, I hope they will alleviate the widespread public anxiety about the potential "bankruptcy" of the program.

Moreover, their adoption should make it possible subsequently for the executive branch and Congress to consider eliminating the inequities and some of the inadequacies in the present system.

Let us look at the short-range need before examining the individual components in the administration's proposals. It is desirable to separate out some of the different elements to determine the net amount of new revenues needed.

One, the overall OASDI needs are estimated at $83 billion for the period. About $7 billion will be shifted from the HI contributions yield to the OASDI program resulting in a $76 billion net yield required for OASDI.

Two, by reducing the reserve requirements from about 50 percent of a year's benefit payments to 35 percent, a saving of $24 billion is obtained over this period. This reduces the net yield required for OASDI to $52 billion.

Three, about $3 billion during this period will be saved if a new eligibility test for dependents' benefits is enacted to offset the effect of the *Goldfarb* decision by the U.S. Supreme Court. Thus, the proposals assume the raising of $49 billion in new income of which $14 billion would not result in any immediate new taxes and $35 billion would be in new taxes.

Four, the $35 billion in new taxes during 1979–82 would be raised as follows: increase in the self-employment contribution rate, $1 billion.

Senator Nelson. That proposal is 1.5 percent?

Mr. Cohen. One and one-half times. I will discuss those in more detail later.

The increase of $1,200 in two steps in the employee earnings base——

Senator Nelson. In addition to?

Mr. Cohen. Yes. That would raise about $4 billion more during this period.

The third, and of course, what is the biggest part of the whole proposal, is taxing employers on the full earnings of the employee without giving the employee any benefit credit for any amount above the employee earnings base. That raises about $30 billion under their estimate.

That makes it about $35 billion, which really are the main proposals that you have to deal with in terms of the macroeffect on the economy of the new legislation.

Now, let us take up first this issue on the reserve fund ratio, because that is basically related to the administration's proposal for the so-called $14 billion in the countercyclical idea related to triggering a general revenue contribution when unemployment exceeds 6 percent.

First, we have to decide, before we look into that, what is the desirable reserve ratio that the system ought to have, and if you decide,

as I shall discuss, that the reserves have to be larger, then you have to raise more money. If you decide the reserves could well be smaller, you do not have to raise as much income to move the reserve up.

A key issue in determining the amount of new revenues to be raised in the short run is the level of reserve to be established in the four separate funds which are now maintained.

There are four separate trust funds, or accounts, for social security. First is OASDI, the old age survivors insurance benefits, which is a trust fund in which the income and outgo and the reserve are separately maintained by law; and the disability insurance fund, which separate fund was created by the action of the Senate Finance Committee in 1956 to separate it.

Then, the hospital insurance trust fund and then the supplementary medical insurance for physician's coverage. Although we talk about social security and about the trust fund and the amounts in the trust fund, they actually are four separate ones for which the accounting is maintained.

That is an important point, because, although there is a total amount available in the four funds, the disability insurance one is going to go broke next year, according to the estimates, before the others do, so you really have an imminent problem, even though there is money in the other three funds, the disability fund will be exhausted next year. Therefore, you must do something by next year to enable the disability benefits to continue to be paid.

Senator NELSON. For clarification, when you say it will be exhausted, what we are really saying is the outgo or the demand on it will be larger than the income?

Mr. COHEN. The outgo has been larger these last few years than the income, thus reducing the reserve that already existed, and the reserve will be completely eliminated next year.

Senator NELSON. There still will be money coming in?

Mr. COHEN. Still money coming in, and still money that potentially is to be paid out. So some people could be paid, but not everybody could be paid, because there will not be enough coming in.

Senator BYRD. May I ask a question at that point, Mr. Chairman?

Senator NELSON. Yes.

Senator BYRD. At what level is your reserve now?

Mr. COHEN. I can give you the different reserves. As I was trying to point out, there are four different reserves, Senator Byrd.

Senator BYRD. Are you speaking of the disability fund?

Mr. COHEN. The disability fund, I think you will find it in the blue book, page 34.

Senator BYRD. I am wondering what percent that is of the total.

Mr. COHEN. You can see here, in 1977——

Senator BYRD. At 48 percent now?

Mr. COHEN. At 48 percent?

Senator BYRD. This book gives it at 48 percent.

Mr. COHEN. Yes; and in 1978——

Senator BYRD. It is 28 percent.

Mr. COHEN. As you see, by 1978, 1979, right in there, according to the estimates, there will not be any more money in the reserves.

Senator BYRD. What do you regard as an appropriate level?

Mr. COHEN. I am going to discuss that now. I think that is a rather difficult question, Senator Byrd, but I am going to try to do my best in discussing what I think it ought to be. But I think that has some difference of opinion.

I will try to historically tell you—I can also tell you what you and your father and I agreed—that is, your father and I agreed some years ago—on what the reserve has been, but the committee has changed what your father and I agreed upon.

Senator BYRD. I believe that I would agree with my father and you.

Mr. COHEN. I think you had better reserve judgment on that. I think at that time we were much more conservative about what we thought ought to be done than what Congress has done in the meantime.

Senator NELSON. He would still agree with you.

Mr. COHEN. You have to keep in mind, Senator Byrd, as I was saying, the larger you make the desired reserves, the more revenue you have to raise on employer and employees to build that reserve up. The smaller you make the reserves, if you can, the less revenue you have to get from employers or employees or the general revenue to bring them to the desired result.

On the one hand, there is the scientific problem of what is the reserve; on the other hand, there is the political one of how much you want to tax employers and employees to get that reserve.

During the early years of the system, when Senator Byrd, Sr., was the chairman of this committee, we wrote into the law that the Board of Trustees was required by law to report immediately to the Congress whenever, in the ensuing 5 fiscal years, either of the trust funds will exceed three times the highest annual expenditures from such trust fund anticipated during that 5-year period, and whenever either of the trust funds is unduly small.

That was at a time when Congress was very concerned about the future liabilities and felt that a much larger trust fund ought to be built up so that if there was something like what occurred during this recent stagflation period, Congress would have enough time to do whatever it wanted to without being pushed under the gun to do something about raising taxes during a period of unemployment.

I think that was a major concern at that time; namely, give Congress enough time to turn around. Do not push us into a situation where we have to raise taxes so quickly that it might have an adverse effect on business.

However, by 1960 that section was repealed, because generally people felt that that required you to build up too big of a reserve and you were taxing employers and employees a little too much.

In recent years, the appropriate reserves have been thought to be equal to about 1 year's benefit payments.

I would say, until the present time, that was sort of the general conventional wisdom—have at least a reserve that each of the trust funds that equal 1 year's benefits, so that if an unfortunate economic situation or an error in the estimates or a change in the fertility rate, whatever, occurred then, with the money coming in, as Senator Nelson has said, and the money going out, 1 year's reserve, it would give Congress 2 years to make any necessary change.

I think that was the philosophy up until now—1 year's benefits payments gave you about 2 years to change the law if you had to.

Senator Nelson. It probably would give you quite a bit more than that because it would be presumed that nothing was going into the fund.

Mr. Cohen. That is correct. What I meant was—you are quite correct that it would give you a little longer, but Congress at least would have 2 years to enact something which might be effective in the third or fourth year. That is, you would not necessarily assume that a new tax, if Congress—as I recall many times in appearing before this committee, particularly when Senator Williams was here, he always wanted to be sure if we were putting a new benefit in that the new tax went in at the same time that the new benefit went in to get the two closely together.

Usually you could not put a new tax in before the beginning of the next calendar year, at a minimum. If you want to give labor and business, which has collective bargaining contracts, notice, sometimes this made it a year or more away. I think that was the philosophy as best I can explain it, of 1 year's benefits as the benefit ratio.

Senator Byrd. Am I right or wrong in thinking—it seems to me that is reasonable, it seems to me about what you ought to have.

Mr. Cohen. I always thought so, before we got into the present situation. That was my objective.

However, in recent years, because the reserve went down, people—and many of the economists who are worried about the impact of a payroll tax on both business and labor, particularly in relatonship to the problems of competition and the overseas situation about the effect of the payroll tax, one of Senator Long's concerns—I have talked to him many time about that. People have begun to say well, maybe we could get to the point where the reserves would be 50 percent of 1 year's benefit payment and still give Congress enough time to turn around in a year, year and a half.

So, that attitude, I think, has been discussed for two, three years.

Now, the Carter administration is suggesting that it is possible to reduce the reserve ratio to about 35 percent of the average for the period 1978 to 1983, and in the President's proposals, combined with this financing out of general revenues, they go to a 35 percent on the average for the funds, and they estimate that if you do that, it will save about $24 billion in revenues which otherwise would have to be raised during that period if the fund were at 50 percent.

So that I think, Senator, my view today is, while I would, in general, favor 1-year benefit payments, maybe temporarily, at this particular moment when we happen to have high employment and high inflation rates, temporarily I think we could well go to 25 or 35 percent for this short period of time, and then raise the reserve ratio after 1981, when we are going to have a balanced budget. That is something you do have to consider.

Senator Curtis. Mr. Chairman, if I could ask a question at that point.

I am pleased to know that in the passing of time and the addition of a few pounds, your optimism has not faltered. Now, this so-called saving by reducing the reserves, that is a one-time saving, is it not?

Mr. COHEN. It is a one-time saving for this period of time, yes. It would not be a saving if you restored it later.

Senator CURTIS. Unless we change the law as to how we finance social security, every dollar that is paid out has to be collected from employers or employees or the self-employed?

Mr. COHEN. At the present time, yes, sir.

Senator CURTIS. If we go to a 4-month reserve, the only difference between 4-month and zero reserve is the zero reserve is definitely a hand-to-mouth existence.

If the experts get surprised and our economy takes a dip or something or other, there is not any money. I think that we are overemphasizing what would be gained by lowering the reserve from 6 months to 4 months. All we are saying is let's spend some money out of the reserve deliberately and get along with a 4-month reserve, really not any saving.

It is dipping into the existing reserve to lessen the problem now. Lowering the reserve does not lessen the demands to be paid, does it?

Mr. COHEN. Not for the future. I find myself in this difficult position. I would like to build the reserve back to a larger point because I think it gives the beneficiaries a greater degree of security about being paid, not an economic matter, but more of a psychological matter.

But if you build the reserve up you either have to tax employers or employees more now to bring that money in to build that reserve higher or you have to put some general revenue obligations in the fund, or some combination, to get it back up there.

Senator CURTIS. That is very true. The reason the reserve went down was because Congress deliberately decided to spend out of the reserves rather than tax.

Mr. COHEN. Yes you are correct. President Ford did send up, on at least two occasions, other proposals for increasing the revenues which Congress did not adopt. Congress did decide to let the reserve drop down rather than raising more money.

Senator CURTIS. The House of Representatives passed a bill increasing social security benefits by 5 percent in 1972 and made some adjustments in the tax program, and then it was subsequently raised to 20 percent on the same tax features as they originally provided for the 5 percent. Is that not true?

Mr. COHEN. I do not recall the details immediately, so I cannot verify that offhand.

Senator CURTIS. Now, this $83 billion that the administration says they are going to raise, I believe I understand your testimony that $35 billion of that would come from increased taxes?

Mr. COHEN. That is correct, sir. That is my understanding of the administration's proposal.

Senator CURTIS. Out of that $35 billion, $30 billion would come out of the employers' tax?

Mr. COHEN. Yes, sir.

Senator CURTIS. The increase on the employees would be zero on 87 percent?

Mr. COHEN. Yes, because of your point about the increase and the earnings base on the employee without a change in the rate.

Senator CURTIS. When we decide to get more money by raising the base upon which to apply the tax, we also incur a greater obligation for paying benefits, by raising the base, do we not?

Mr. COHEN. On the employee, yes, but not on the employer, by this proposal of the administration.

Senator CURTIS. The employer does not draw benefits.

Mr. COHEN. Taking the base off of the employer tax does not increase the employee benefit liability.

Senator CURTIS. Raising the employees' tax will increase the liability.

Mr. COHEN. Yes, you are correct.

Senator CURTIS. In this tabulation, no allowance has been made for that, has it?

Mr. COHEN. That liability comes in the future. It would show up in whatever the actuarial statement of the fund was, 20, 30, or 40 years from now, because most of that would not be paid out in the near future.

Senator CURTIS. You do generally support this $83 billion package for the next 5 years of the administration?

Mr. COHEN. I would say, while I generally support it, I do not think you need, as I am trying to develop here—you do not raise all of that money, of course, from the employer, because you can change the reserve ratio, as I am trying to develop.

Thus, the big point would be the $35 billion. If I could proceed on one further point, I think I could explain this to you, Senator.

My answer to your question is yes.

Senator CURTIS. You generally support it?

Mr. COHEN. Yes.

Senator CURTIS. What factor in their package accounts for benefit increases? They tell the country, this is going to make the fund whole, but how many increases in benefits are they estimating will be made in the next 5 years?

Mr. COHEN. Under this proposal, the only increase in the benefit that is in their proposal is the increase of $600 in two steps in the employee earnings base, which is the only provision that improves benefit obligations or liabilities.

Senator CURTIS. Do you believe that the Congress is going to go 5 years without raising social security benefits Mr. Cohen?

Mr. COHEN. Five years? No, I do not think that is possible.

Senator CURTIS. You have left that out entirely.

Mr. COHEN. Let me say first there is an automatic increase in the benefits in the existing law, as you know, that is related to both the cost of living and, in effect, to the changes in wages that was enacted in 1972 at President Nixon's recommendation. I supported that proposal then; I support it now, that there be in the law an automatic increase in relation to wages and prices.

However, I would like to say this. There is nothing in the law that prevents Congress substituting its own judgment every 2 or 4 years, as it sees fit as a substitute for those automatic increases. I think I will be back here at some time suggesting that Congress do that, because I think an automatic increase just in prices does not deal with many of the internal inequities and inadequacies in this system.

My answer to your question is yes, I think the problem of future benefit changes is important. In my paper, I recommend that the advisory council on social security be required by law to be appointed to look into those and give their recommendations in the next few years to the Congress.

Senator CURTIS. Who was Mr. Okun?

Mr. COHEN. He was a member of the Council of Economic Advisers during the Johnson administration. He is now a member of the staff of Brookings Institution.

Senator CURTIS. It is his formula and analysis that causes you to arrive at this $14 billion.

Senator NELSON. What $14 billion?

Senator CURTIS. The countercyclical general fund financing. It is on the chart.

Mr. COHEN. I did not know that Mr. Okun was the originator of it.

Senator CURTIS. I do not know if he originated it. I know that is the only thing that you can justify it by, that it is not in conformity to the facts. That is sort of a back door idea of financing social security out of the general fund.

The difference between—in other words, the loss to the social security fund say, in calendar 1976, the advisory committee estimated unemployment at 4.9 percent. It actually became 7.7. The actual loss of social security taxes was only $27 billion.

Mr. COHEN. That is another way to look at it.

Senator CURTIS. Is that not the right way?

Mr. COHEN. You are way ahead of my paper here, in which I discuss this at some length.

Senator CURTIS. I would like to have you explain. I am not questioning it, I just do not understand this new eligibility test for dependents.

Mr. COHEN. I will discuss that, too.

Senator CURTIS. All right.

Mr. COHEN. However, let me say this while we digress, because we will come to it on this matter of the $14 billion which is for the short-term, is called the countercyclical proposal. The idea is to pay into the trust fund what it lost by excess unemployment. I call it the excess unemployment rationale.

There are two things to be said about it, when you consider it. One is that it is a self-limiting device. It is not an open-ended proposition like other proposals for general revenue financing. Even if you are opposed to general revenue financing, as I am sure some people in Congress are and will be, this device was suggested by various economists because it was self-limiting. By that, I mean it is not open ended.

It was a measurable mathematical device which had no relation to benefit liability. Therefore, it could not become an argument for an increase in benefits.

So, number two to keep in mind on the advantage side, it does not require any money from the budget during this period of time. It does increase the national debt, but it does not require the Congress and the budget committee to add, during that period of time, $14 billion to the budget estimates.

That is the part of the ingenuity of this system.

Senator CURTIS. Are you coming up with a plan to finance the Social Security with government bonds?

Mr. COHEN. The genius of the idea is to put Government bonds into the system that would show up as an increase in the national debt, so it is a liability of the Government, but it would not show up in the budget.

Senator CURTIS. Why not put in a few more carloads of bonds and cut the taxes?

Mr. COHEN. The trouble with that is, you can put more bonds in if you want, but when you come to need the money and you have to cash in the bond, then you have to go into the open market with other bonds to raise the money.

It is not intended—let me say this, so you understand the administration's proposal. It was not intended that we would ever cash in these bonds. They would be in the reserve.

The idea was the bonds would not be cashed in, be a debt of the Federal Government, but not show in the annual budget.

Senator NELSON. As you know, there is much concern among many members about going to the general fund, directly, indirectly, or however. Why could you not avoid the $14 billion bond question from general revenues by letting the reserve go to 25 percent then building it back up to 35 percent, or wherever you want to go for a longer period of time, and avoid the whole question?

Mr. COHEN. You could. I would suggest, if I may say one other thing, and that is that I would like to put back in the law the Vandenberg amendment which was in the law from 1944 to 1950.

Senator CURTIS. Until I made a motion to take it out.

Mr. COHEN. I think you did, in 1950. May I say, I think that was unfortunate. I was a party to it, too. I recall Mr. Mills and Senator Byrd, Sr. in conference, and the rest of us, taking it out, all because it was not needed. It was never needed during that time, but it gives a tremendous psychological support to the system to say that.

I think we had better explain it for Senator Danforth. He probably does not know what we are talking about.

In 1944, Senator——

Senator DANFORTH. I did come somewhat later than 1944.

Mr. COHEN. It is a strange circumstance for me to be an old-timer here, but I guess that is what it is.

In 1944, Senator Vandenberg was much concerned, and so was Senator Byrd, about increasing the tax rate that was supposed to go up during the war and so they did not want to raise the social security contribution, on the grounds that it was not necessary and we had a lot of other problems.

So the issue came up, which was the same issue today. If you did not raise the tax now, you had to raise it later on.

Senator CURTIS. It was to freeze taxes against automatic raises automatically in the law.

Mr. COHEN. That is correct, sir.

The point was raised by Senator Murray that you either have to raise the tax on employers and employees later on or get money from general revenues, and Senator Vandenburg said yes, you are right.

They said, what are you going to do when the time comes, if they do not raise the payroll tax enough to finance the balance?

Senator Vandenberg said, then you would have to raise it from general revenue. Senator Murray says, why do you not put such a provision in the law?

Senator Vandenberg said on the Floor of the Senate yes, I will support such a provision. So we had the so-called Murray-Vandenburg amendment from 1944 to 1950 that said if the reserve fund ever ran out of money, there could be a direct appropriation to the fund. It was never used.

But in my opinion, I would strongly hope that that could be put back in the law, because it says to the media, the newspapers, the magazines, the columnists, something which is hard to say now, that if the fund ever did come out that people are going to get their benefits.

Senator DANFORTH. Mr. Cohen, I am very surprised at your extraordinary optimism, your rosy view of the future.

Mr. COHEN. I did not think that I had said that.

Senator DANFORTH. It came across to me, well, gee, we will never have to do that, but let's tell the public that maybe we can tap general revenue. We are going to temporarily reduce the reserve, but everybody knows in 1981 we are going to have a balanced budget. Then we can restore it again.

I think that the problem here is a very real problem——

Mr. COHEN. I do too.

Senator DANFORTH [continuing]. On how to finance social security, not in a temporary, short-term aspect type of approach, but what is going to happen in the long run.

It is my understanding that we not only have a problem with the high rate of unemployment that we have had in recent years, which has created the immediate problem, but that we have a demographic problem as well. That is, my understanding of the ratio of those who are over 65 to those who are on the work force is growing, and is going to continue to grow at a very rapid rate between now and, say, the year 2020 or 2030.

It is my further understanding that medical science is not static, that people are now doing research on the process of aging, that there is at least some possibility that life expectancy is going to be substantially increased in the foreseeable future. And yet now we tell ourselves, well, we can reduce the reserve ratio and then restore it, maybe at some later date. You cannot reduce the ratio too many times.

We are told we can have countercyclical spending from general revenue. That countercyclical spending from general revenue, the way the administration has proposed it, simply goes to the shortfall of social security revenues caused by unemployment exceeding 6 percent. It does not go to the demographic problem at all.

I think—maybe I am all wet about it, but I think that we have got to face up to the seriousness of the problem, and it is fine to say that it is not going to go broke that fast, it is not going to go broke. One way or the other, Congress is going to keep social security afloat.

It is too important. But to think that decoupling is going to solve the problem, or that we can have some minor tinkering with the program and that is going to solve the problem, to me is just whistling past the graveyard, and what I would like to know from you is, do

you not think that we had better begin thinking very seriously about the long range problem and whether we should not rethink the whole system and find out if there is not something we can do?

Maybe we should go entirely to general revenue—I do not think so, but maybe we should. Do you not think we should at least start sweating a little bit about this problem?

Mr. COHEN. Yes, sir, I agree completely with you. We have not been addressing that question, we were only discussing the first part, the short range.

Senator DANFORTH. Maybe I have not been looking at the right things, or reading the right things, but I have not heard any recent discussion about the demographic problem and I have looked through your statement and I have not seen it.

Mr. COHEN. No, but I am prepared to discuss it. I would be glad to do so.

There are three issues, if I can identify them, Senator. The short-range problem of these 5 years which I am speaking about, and if you will see later on in my testimony there is a middle-range problem between 1982 and the year 2000, and then there is a longer range one from the year 2000 to 2050 in which most of the issues that you are talking about are related.

In order to get to that long-range problem, we have to live through the first 5 years. I was merely discussing that.

My answer to your question is "Yes." To some extent, the President's proposal deals with all three of them. They deal with the short range. For the middle-range problem, they advance the contribution rate on employers and employees from the year 2011 to 1985 and 1990 and then the decoupling, of course, decreases the longrun costs 4 percent.

There still is a deficit, though, under the existing law because of two things, not merely the demographic, which is related to it, the lower fertility rates and the other situations affecting the population 50 to 75 years from now.

On that latter point, I agree with you that there ought to be a basic consideration of a number of elements, not merely the financing of the system but the benefit structure in relation to that demographic situation.

If I may give you a kind of conceptual view of it, it is entirely possible that 50 or 75 years from now, based upon such factors as the extent of individual savings, the extent of private pension plans, that the replacement rate in the present law and/or the age of retirement ought to be different than they are today.

I do not have an answer to that, but if you are concerned about that, I think you should make a suggestion that the advisory council on social security be required under the law to be set up now to make a report to you and you should amend the statutory provisions in this law to require them to do so, because I agree completely with you. I do not have a glib answer to that. I do have some ideas as to how it could be done.

They involve two basic considerations. Now, let me make one other point, which might substantiate your view that I am optimistic.

When you look at that longrun situation, while the number of aged increases from the present 22 million age 65 and under, the estimates for something like nearly 50 million in the year 2050, according to the

actuarial estimates, and the proportion of the aged in the population increases, the proportion of children in the population declines.

When you are talking about this demographic shift, what my grandchildren probably will be faced with is a very heavy increase in financial liability for older people, but a decline in financial obligations for education and raising children.

When you look at the total of the children and the aging—which might be classified as the dependents in the population—related to the people aged 20 to 65, the dependency ratio 50 to 75 years from now is less than what it was during the last 10 to 15 years.

Yes; you are correct. If you only look at the aged side you would find a very pessimistic situation. But if our economy were to continue to grow in terms of gross national product as it has during the last 75 years and the dependency population declines, we will have to make the internal shifts in the way that we handle the financing of children and aging.

The overall burden may not be very much different than it is today.

I would argue in support of your view that that has to be very carefully studied.

Senator CURTIS. Is it not true if we cut down on the number of children we are cutting down the number of taxpayers?

Mr. COHEN. The population still continues to grow under these estimates. I do not think——

Senator CURTIS. Every time the birthrate cuts down, you cut down the influx of wage earners and taxpayers.

Mr. COHEN. That might be also decrease the extent of unemployment in the future, too, because what we have been having is very high unemployment rates among young people and if there are internal shifts in the way that we handle education and placement and we have increased productivity, it is entirely possible, Senator, that this situation might not be as bad as we sometimes think.

That is an optimistic view, I grant you. If you are going to take your postulate about the demographic changes and fertility rates and demographic considerations generally, I think you must bring into consideration the whole business of where people are employed, what their earnings are, how much private savings they have, how much private pension plans they have. If you wanted to reconsider the role of social security, I would not be adverse to that.

Senator DANFORTH. If life expectancy were increased by 10 years——

Mr. COHEN. Ten years. You mean at birth?

Senator DANFORTH. Life expectancy.

Mr. COHEN. Which is now 70 at birth. Were it changed to 80?

Senator DANFORTH. Yes.

Mr. COHEN. I could not even begin to tell you what, under present circumstances, those problems would be. They would be tremendous.

Senator NELSON. You underestimate the ingenuity of Congress. We will raise the retirement age to 80.

Senator DANFORTH. I do underestimate.

Mr. COHEN. Let me say this. You have one problem right now. You do not even have to worry about that so far in the distance.

The life expectancy of women over the life expectancy of men is increasing and has increased since 1900, and you can have your own

reason why that is occurring. I have my own nonscientific reasons, but the fact is, we are going to have more and more widows and women living much longer than men, their spouses, which means a very special set of considerations has to be developed as to how men will be sure that their widows will be taken care of during the period of possible increased inflation.

If you assume that, where they live on the average sometimes 10 years more, on the average, than their men, that is a very serious—that is not a future problem.

Senator CURTIS. Is that what is called the survival of the fittest?

Mr. COHEN. I think you are correct, yes, sir. Women are the stronger and certainly the more persistent and certainly the better of the two sexes in my opinion.

Senator DANFORTH. May I ask you a couple of philosophical questions. Do you think it would be an unacceptable departure from the philosophy of social security to raise the base on employees for the purpose of taxation but not for the purpose of payout.

Mr. COHEN. I would have to define my criteria. I think it would be very unacceptable from a social psychology point of view to say you have to explain to employees why you are paying a tax on a payroll on which you are not getting any benefit.

I think that would be very difficult. Therefore, if you are going to do that, my suggestion would be a different one to achieve it. I would have an earmarked income tax on the system. If that were your idea, that the employee should pay more for whatever economic reasons that you want and that you did not want to raise it from the payroll tax, then I would earmark one percentage point, on either the income tax for employees or the corporation, and define that as a contribution to the social security system.

You can either explain that as general revenue, or as I develop later in my paper, in some other way. On balance, I would not do it. I think it would be very difficult to explain, and justify, even though it has some economic, I have to admit, has some economic basis—but not sufficient for me to encourage you to do it.

Senator DANFORTH. You would make it a progressive tax?

Mr. COHEN. I suggest if you are going to do it, do it through the income tax.

Senator DANFORTH. You think that would be a mistake, too?

Mr. COHEN. No, I do not think that would be a mistake. I think that would be more possible to sell, more rational to sell.

On one of the arguments that I defined later in my paper—in this paper, as you will see, I give you different kinds of rationale for general revenue financing than the one that the administration gives. They may be equally unacceptable to people. I wanted to define that there are ways to justify making the system more progressive, if that is what you wanted to do, and I would be glad to discuss that with you here.

Senator DANFORTH. I would like to differentiate the question of general revenue financing, which is dipping into a big bin and financing social security from earmarking a specific tax for social security but having that be at least a somewhat more progressive tax than what we have now.

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Mr. COHEN. On that point, I agree with you 100 percent. As I say in my paper here, if there is a general revenue contribution, in my opinion I would not make it "dip into a general bin." I agree with the opponents of general revenue financing that that would be unwise.

If you decide to go to general revenue financing then I would finance either a specific benefit or finance a specific element, a specific element that would be definitely earmarked so Congress would have the control and the focus on it. Let me give you an illustration.

In 1965, Congress did vote for general revenue financing in the social security system. It is usually overlooked, but when we came to the solution of the medicare problem and the coverage of physicians under the SMI program, Congress voted that half of that cost should be borne out of general revenues, and today that is something, like $5 billion out of general revenues that you are now putting into the social security system, except it is for an earmarked benefit. Nobody has argued in these 10 years that that has subverted the system, made Congress more willing to add benefits or to distort the system, or anything like that. Most people do not even know there are general revenues in the part B.

Therefore, following the logic of your argument, if general revenue financing were to be put in, I would either earmark it as a tax or earmark it as a benefit, but not dip into a big bin, as you say.

Senator DANFORTH. I want to make it clear that I am not proposing it. I am just asking about it.

Secondly, if Federal employees, as you mention in your paper, may be brought within social security, could this administratively be done? It would be politically impossible and probably legally impossible to take away from Federal employees vested rights they have in the existing pension programs. One approach would be, given the benefits that presently exist for Federal employees, a part of that total benefit would be transferred into social security benefits. Then, similar to people from the private sector, Federal employees would have a pension plan which is integrated with social security.

Administratively, could this kind of thing be accomplished?

Mr. COHEN. There have been proposed to this committee over a number of years several different kinds of plans for bringing Federal employees into the system. They have ranged all the way from what I would call a basic plan, which assumes social security would go under the Federal system and the Federal system would be built on top, just like a private system, or two systems in which Federal employees would only be covered for certain areas where it was coordinated with survivor's benefits and disability benefits.

Every one of those proposals that have been submitted to this committee and the Ways and Means Committee have been criticized by someone as not being the proper solution and, as I said in my paper, I think that you should ask the Social Security Administration which has been working on this for at least 25 or 30 years, to give you now the best plans that they have prepared, and you ought to adopt one of those, because I think—I speak now as a former Federal employee, I served in the Federal Government for 30 years. I have a Federal pension, and I am contributing currently under social security for the past few years because I work for a university.

I believe that Federal employees should be covered under social security. To the extent it is feasible to work out a plan, my answer to your question is yes, it is administratively feasible to work out a plan that would be legal, that would be appropriate, but I think you would have to work out one that is a little different for Federal employees in view of the nature of the Federal system.

Senator DANFORTH. And which would be fair to the employees so that they would not be any worse off than they are now.

Mr. COHEN. I do not think you could ever get a plan through that did not meet that condition. In fact, they would be better off, for some people. Some people would be worse off. Some who can work 35 or 30 years in the Federal Government and then work just 10 years in social security, they get the best of the two plans. That is really the best of the two plans.

You would correct some overlap. You would also correct some people who fall through the sieve, and therefore, in the long run, they would be better off.

I strongly suggest in my paper that if you take any of these suggestions, you must bring State and local coverage mandatorily to social security, and you must extend it to the Federal employees, because it will become more and more of a discrepancy in the contributions and in the benefits if you do not do that.

Senator DANFORTH. There may be a constutionality problem; witness the wage and hours case.

Mr. COHEN. On the State and local employees? Yes. I have a solution for that, though. I think you can get around the constitutional question. I will be glad to discuss that with you and indicate how it might be done.

Senator DANFORTH. I have taken up too much time already.

Mr. COHEN. I think you have raised an extremely important point. As you increase the rate on the employer and the employee, you are going to encourage State and local governments to withdraw from the social security system once they have 5 to 10 years in, and they have the cream of the actuarial advantage.

Mayors and Governors are going to say, we have given you 60 to 70 percent of the advantage at 20 percent of the cost, let's move out of the social security system. Five years or ten years from now, everybody can have it. If you retire at age 60, you can always get 5 more years on Social Security, et cetera, et cetera.

If that is going to happen, Congress has to close that door, because it will not only be a financial disadvantage to the system, but you will eventually then have to raise contribution rates from the employers and employees who stay in the system more than you otherwise would have. That is unfair.

Senator NELSON. Could you please complete your statement. We have two more witnesses.

Mr. COHEN. I think we have touched on quite a number of things. I will only deal with one thing. You did ask me the question on the *Goldfarb* decision. I would be glad to talk about that.

Senator CURTIS. I did not want to take undeserved time. What does the chairman have in mind? I am not a member of this subcommittee. I did want to hear this testimony today and I have to keep another engagement.

Senator Nelson. My plan was to run until we finished because I have a conference on the youth employment and training bill beginning at 2, so we will run right through the noon hour. We will have to.

Mr. Cohen. I think if I deal with the *Goldfarb* decision, I have touched on every major aspect.

There are, of course, other kinds of issues that are not discussed here that we ought to talk about. On the *Goldfarb* decision, in my opinion, Senator, there are three ways to handle the Supreme Court decision in the *Goldfarb* case: continue to apply the present law without any dependency test for either men or women. That is really what the net result is of the *Goldfarb* decision. This will add $7 billion in additional costs to the system that Congress did not anticipate when it passed the law previously.

If this policy were to be continued, consideration should be given to paying these anticipated costs, possibly from general revenues. I do not favor this alternative.

Alternative two is to provide a dependency test for men and women in order to meet the Court's decision. As I interpret it, we only had the dependency test we had before, the case for men and not for women. If you had dependency tests for the two of them, that would be constitutional.

This would increase administrative costs, in my opinion, terribly, to ask every woman, every spouse, to identify her dependency. In probably 80 or 90 percent of the cases she would automatically be ruled eligible.

It seems to me to be a waste of administrative time and subject women to a test that is not necessary. You have to bring information about the husband's income, what their income was, and so on.

I believe, while that may be what may be submitted to you by the administration, I am equally unhappy with that. I think it would involve unnecessary administrative work, particularly delayed payments, and subject women to the kind of having to bring in information which they may not be completely familiar with, particularly after the husband has died.

Senator Curtis. Is that where they say they were going to pick up $3 billion?

Mr. Cohen. Yes, sir.

My third is another way that I hope you will have the staff look into. Request the Social Security Administration to present a plan for taking into account retirement or pension payment under Federal, State or local public plan, which is not supplementary to the basic social security system, where the male spouse receives a pension from a public plan which is a substitute for the basic social security plan, such pension should be treated as if the pension was a social security benefit. Under existing law, the individual receives whichever is the higher.

This policy would also encourage coverage of Federal, State and local public employees who would then not have this dual benefit provision applied to them.

If you recall the *Goldfarb* case, the *Goldfarb* case was a case where the man was receiving a pension from a public employee plan,

Whether it was Federal, State, or local, I do not remember. Of course, that was in the case where social security was not applicable. If he had been under social security, why he would have gotten his social security benefit. Therefore, there would not have been any discriminatory treatment.

You really ought to look at this third alternative. I am not clear how much money it would save, but it is a better one than making every woman have to submit material on dependency.

Well, Senator, in conclusion, I would say this. There are various other proposals that are pending, and I only discuss one in my paper, because I did not want to submit a 100-page paper with all of the things that I think should be changed.

But there is one bill that is pending before the Congress which I feel is important.

This is S. 114, by Senator Church, and I think 50 Senators have joined, to restore the Social Security Administration to a Board, as it was originally, when Mr. Altmeyer was the Chairman of the Board.

When social security was first created it was created as an independent board of three people, not more than two could be from any political party. That remained until about 1946. My view is that social security is getting so big, it involves so many employees, it involves so many people in the country, employees and employers, it should be, as far as humanly possible, insulated from changes in political administration with regard to the operation of the program.

In other words, my view is that Congress should designate three or five members of the Board, with overlapping terms of 6 years. I think Mr. Church's bill says 4 years. Then you should isolate the Board from the political process and the recommendations that come to you through the President should be the recommendations of the Board so that as far as possible this program which roughly is at the $100 billion level now and is going to $125 billion, $150 billion, is going to involve 5 or 6 percent, 7 percent of the gross national product, would, as far as possible, be insulated from contemporary changes and utilizing the benefits system in a political way.

I recognize that it cannot do it entirely. There is no way to eliminate political consideration. The system is getting so big, so important, so pervasive, that one of the things you ought to consider is try to find a way from insulating it from just sheer political manipulation.

Senator Nelson. Are there any questions?

Thank you very much, Mr. Cohen. We appreciate you taking the time to come here.

[The prepared statement of Mr. Cohen follows. Oral testimony continues on p. 101.]

Statement of Wilbur J. Cohen

SUMMARY

1. Supports the general thrust of the President's proposals to restore the financial integrity of the social security system.
2. Supports "decoupling" amendment.
3. Supports transfer of some Hospital Insurance Income to Cash Benefits.
4. Supports increase in self-employment contribution rate.
5. Endorses future increase in employer and employee rate increases in 1985 and 1990.

6. Presents considerations for lowering the reserve ratio and reenactment of the Murray-Vandenburg amendment to assure payment of all benefit liabilities if needed from general funds.
7. Presents various rationales for any future general revenue financing.
8. Recommends further increases in employee maximum earnings base.
9. Recommends stretch-out of elimination of employee earnings base for employer contributions.
10. Suggests further consideration of mandatory coverage of state, local, and federal civilian employees.
11. Endorses Church-Vanik bill to restore Social Security Board.

STATEMENT

I am pleased to appear before this Subcommittee today to discuss the President's recommendations to strengthen the financing of the social security system.

As a former member of the Board of Trustees of the social security system, I have a deep interest in safeguarding the financial integrity of the program. As an individual soon to become 65 years of age, I have more than an academic interest in this matter. But an even more personal factor is that the early training I received at the University of Wisconsin under the guidance of Professors John R. Commons and Edwin E. Witte, and later from Arthur J. Altmeyer, has reinforced my commitment to the institution of social security as a continuing compact between the people and their government.

General Considerations

Social security has become an institution which has widespread support. In an era of skepticism, doubt, and criticism of government programs and policies, it should be heartening for members of Congress to know of the general acceptance which their efforts over the past 42 years have wrought. Our responsibility today is to maintain and preserve public confidence in the program and to locate the necessary revenues to assure the program's financial soundness. The Congress act as the Board of Directors of this vast system. Over the years it has acted in a responsible manner to maintain a financially sound and acceptable benefit program. You are in a position to extend that excellent performance record this year.

Social Security presently involves current disbursements of over $80 billion annually, 33 million beneficiaries, 100 million individual contributors, and over 5 million business enterprises. In the long run, everyone in the nation is affected by social security contributions and benefits.

I strongly support the general thrust of the President's proposals. However, there are other alternatives to achieve the same overall result of restoring the financial integrity of the system. There are advantages and disadvantages of every method of increasing revenues to the system. The weighing of these advantages and disadvantages involves not only economic and fiscal considerations (including the incidence of taxation), but social psychology as well. I don't think it is possible to make decisions on these complex factors as if they could be made on some scientific basis.

The most important criteria in determining the measures to be adopted is that the general public and the media should be persuaded that the Congressional decisions assure the financial integrity of the system and that there is an equitable sharing of the costs. There is a "conventional wisdom" about the concepts of financial integrity and equity in relation to both the contributions and benefits of the system which is shared by the general public which is substantially different than the views expressed by Milton Friedman and economists from the Brookings Institution and elsewhere. While I believe full and thoughtful consideration should be given to the views of macro-economists, I believe the Congress should be guided by balancing all the factors involved.

President Carter's recommendations for restoring the financial integrity of the social security system are important, responsible, and urgently needed. His proposals will produce: 1) additional income to the social security system over the next five years; 2) provide additional income to the system beginning in 1985; and 3) eliminate the flaw in the indexing for inflation enacted in the 1972 amendments which will reduce the long-run cost by about 4% of pay-

rolls. When enacted, as I hope they promptly will be, I hope they will alleviate the wide-spread public anxiety about the potential "bankruptcy" of the program. Moreover, their adoption should make it possible subsequently for the Executive Branch and Congress to consider eliminating the inequities and some of the inadequacies in the present system.

The Short-Range Need

Before examining the individual components in the Administration's proposals, it is desirable to separate out some of the different elements to determine the net amount of new revenues needed.

1. The overall OASDI needs are estimated at $83 billion for the period. About $7 billion will be shifted from the HI contributions yield to the OASDI program resulting in a $76 billion net yield required for OASDI.

2. By reducing the reserve requirements from about 50% of a year's benefit payment to 35%, a saving of $24 billion is obtained over this period. This reduces the net yield required for OASDI to $52 billion.

3. About $3 billion during this period will be saved if a new eligibility test for dependents' benefits is enacted to offset the effect of the *Goldfarb* decision by the U.S. Supreme Court. Thus, the proposals assume the raising of $49 billion in new income of which $14 billion would not result in any immediate new taxes and $35 billion would be in new taxes.

4. The $35 billion in new taxes during 1979–82 would be raised as follows (in billions):

A. Increase in the self-employment contribution rate—$1.

B. Increase of $1200 in two steps in the employee earning base—$4.

C. Taxing employers on the full earnings of the employee—$30.

The Reserve Fund Ratio

A key issue in determining the amount of new revenues to be raised in the short-run is the level of reserve to be established in the four separate funds which are now maintained: OASI, DI, HI, and SMI. The larger the desired reserves, the more revenue which is needed to build them to the required size; the smaller the reserves, the less revenue is needed to build them to the desired amount.

During the early years of the system, the Board of Trustees was required by law to report immediately to the Congress whenever the "ensuing five fiscal years either of the Trust Funds will exceed three times the highest annual expenditures from such Trust Fund anticipated during that five-year period," and whenever either of the Trust Funds is unduly small (Section 201(c)(3), repealed in 1960).

In recent years, the appropriate reserves have been thought to be equal to about one year's benefit payments. The current reserves for OASI and DI are much less than that at this time. In fact, the reserves for DI are estimated to be exhausted by next year. This is the reason why legislation is needed this year.

The Carter Administration's proposal assumes that it is appropriate to reduce the reserve ratio for OASDI combined to about 35% on the average for the period 1978–83. They estimate that this saves about $24.1 billion in revenues which otherwise would have to be raised during this period.

Temporarily the reserve funds could be reduced even lower than the $36.1 billion figure estimated by the Administration for 1978 and the $37.6 billion figure estimated for 1979.

It would be possible to support even a lower reserve figure as long as the Congress replaced in the law the Murray-Vandenburg amendment which was in the law from 1944–1950 which stated:

"There is also authorized to be appropriated to the Trust Fund such additional sums as may be required to finance the benefits and payments provided under this title." (Section 201(a), last sentence, repealed in 1950.)

Should for technical reasons the Secretary of the Treasury need some minimum level of reserves to handle his cash-flow and refinancing problems, this could be met by statutory authorization of either repayable loans or advance payment of amounts due for military service credits and the Medicare subsidy for the ensuing two years, or both. This would temporarily handle any short-run emergency which would enable Congress to have sufficient time to remedy the situation.

The Four Major Revenue Issues

Four major revenue issues are presented in the President's recommendations pending before you:

1. How far and how fast is it desirable to increase the rate of employers and employees equally?
2. How far and how fast is it desirable to increase the maximum earnings base on employers and employees equally?
3. Is it desirable, and if so, how fast should be maximum earnings base be eliminated on employers?
4. Is it desirable, and if so, to what extent, and on what rationale, should general revenues be utilized for financing cash benefits?

Contribution Rate Changes

The Administration's proposal involved two increases in the *rate* of the payroll contribution on employees (and employers). The first involves acceptance of the rate increase already incorporated in the existing law for hospital insurance benefits in 1977 and 1981, a rate increase of two-tenths of one percent on employees and an equal rate increase on employers in 1977 and a further increase of a quarter of one percent each in 1981. (There is a further increase of 0.15% each scheduled for 1986.)

The other rate increase involves moving forward the rate increase scheduled for the year 2011 to 1985 and 1990.

I support both of these rate increases. In part, they are feasible in my opinion in view of the enactment of the earned income credit in the federal income tax law which provides for the refund of an amount equal to 10% of earnings up to $4,000 a year for a person with dependents. The refundable amount is reduced above $4,000 until it disappears at $8,000 a year. I suggest that consideration be given to amending the law so that it will apply to any individual and that the basic amount be increased from $4,000 to $4,500 in 1978, $5,000 in 1979, $5,500 in 1980, and $6,000 in 1981. These changes would give assurance that the payroll contributions would not have an adverse impact on the expenditures, consumption, or standard of living of low-income receivers.

In passing, I should like to point out that many low-income taxpayers are not aware of the earned income credit in the tax law. Nor is the public generally aware of its existence or purpose. I urge that both the Treasury Department and the Social Security Administration publicize it more widely.

Maximum Earnings Base

I would have preferred increasing the employee maximum earnings base by $900 each in four future years: 1979, 1981, 1983, and 1985 instead of the $600 each recommended by the Administration.

I believe that a $30,000 maximum annual earnings base by 1982 is a desirable objective in terms of the objective of the 1939 law. The Administration's proposal is estimated to reach $24,600 by 1982.

I would also suggest stretching out the repeal of the maximum earnings base on employers over a longer period than the three years recommended in the President's proposal.

In evaluating the impact of increased contributions on employers and employees and the justification for requiring employers to contribute on the entire earnings of employees, it is important to keep in mind the federal tax law on contributions and benefits.

Employer contributions to the social security system are deductible as business costs when paid. From an economic point of view, they are treated as deferred wages. (The exclusion of employer pension contributions and earnings is estimated to produce a revenue loss of $9.940 billion for individuals in 1978 not counting a $1.535 billion loss for self-employed and other plans.)

Employee contributions to the social security system are not deductible. Hence, many employees pay federal income taxes on the income used for social security contributions. However, the benefits paid are not taxable.

(The exclusion of OASI benefits for the aged is estimated to produce a loss of $3.460 billion for 1978.)

In general, then, employers are encouraged by the federal tax laws to provide deferred wages for pensions, health, and welfare benfits since for most corporations approximately one-half of the contributions are paid for by the U.S. Treasury.

Thus, under the tax laws, employer contributions for pensions are given greater encouragement than employee contributions.

Self-Employed Contribution

The Administration proposal restores the self-employed contribution rate to one and one-half times the contribution rate on employees. This was a reasonable compromise between considering the self-employed rate as an employee rate only or a combined employee and employer rate.

If the one-half of the employee rate is considered as an employer contribution, then this portion could be considered as deductible from the self-employed person's income. This might make the higher cost to the self-employed person more acceptable.

General Revenue Financing

I wish to make it clear that I would be opposed to any change in the financing of the program which would result in the introduction of any general income and/or resources test for benefit eligibility. I do believe that some general revenue contributions can be justified without impairing the contributory earned-right character of the system. There are several different ways in which this might be accomplished.

1. *The excess unemployment rationale.*—This is the proposal in the Administration's recommendations. The proposal utilizes 6 percent as the trigger but a good justification also could be made for 4 percent or some other figure, such as 5 percent or 5½ percent so as to reduce the need for additional payroll contributions.

2. *The accrued liability rationale.*—Under this rational a general revenue contribution would be justified for the payment of the benefits during the period when the full cost over a 40-year period was not borne by the contributors. This approximates about one-third of the long-range costs.

3. *The excess inflation rationale.*—Under this justification any automatic increase in benefits above a long-range price increase average, such as 1½ percent or 2 percent a year, would be borne, in part or in whole, from general revenue contributions.

4. *The loss of revenue rationale.*—Senator Vandenburg's endorsement of general revenues in the 1944 amendment was due to the freezing of the contribution rate during World War II. This loss could be identified and reimbursement made from general revenues. Other revenue losses could be identified.

5. *The minimum benefit rationale.*—Under this justification, general revenues would be utilized to pay the difference between the actuarial value of the contributions of those receiving the minimum benefits and the actual minimum benfits received. Thus, for illustration, if the individual received a minimum benefit of $100 a month but the actuarial value of the individual's contributions were $30, the $70 difference would come from general revenues.

6. *The Medicare rationale.*—At present, one-half of that part of the Medicare benefits relating to physicians' services (Part B of Medicare) is paid for from general revenues. This policy was included in the program when it was first enacted in 1965 and has been in effect for the past 12 years. It has not impaired the insurance or earned-right principle of the program. If this same policy were applied to hospital insurance (Part A) it would result in about $10 billion being made available for cash benefits under OASDI.

7. *Other benefit-payment rationales.*—Under this rationale, general revenues could pay part or all of a specific benefit cost, such as the cost of any benefits mandated by the U.S. Supreme Court, or benefits paid to students between ages 18–22, or for rehabilitation of disabled persons, etc.

8. *The savings in Old Age Assistance costs.*—If Congress had not enacted a social insurance program, the federal revenue cost for Old Age Assistance (1935–1973) and Supplemental Security Income (beginning in 1974) would have been several billion dollars a year more than it has been. Without a OASDI program, it is likely that one-third of all aged persons would be eligible for some supplemental income and possibly one-half of all permanently disabled persons.

9. *The Government Loan Device.*—Some contingency reserve is needed for the system to take care of short-run economic variations and to enable Congress to have sufficient time to consider alternative ways to meet unexpected developments. Instead of requiring employers, employees, or the government to make contributions to assure such a contingency reserve, the federal gov-

ernment could loan the amount needed or there could be some combination of contributions and loans.

In considering the general policy issue of general revenue financing, it should be pointed out that both the 1938 and 1948 Advisory Councils on Social Security unanimously advocated use of general revenue funds for cash benefits. In addition, the 1971 Advisory Council recommended that one-third of the combined cost of the Medicare program (both HI and SMI) be paid from general revenues, and four members recommended general revenues for the cash OASDI benefits. A majority of the 1975 Advisory Council decided against the use of additional general revenue financing in the cash benefits program but recommended that the full hospital insurance contributions be shifted to the OASDI system (in 1978 a combined total of 2.2 percent, rising to 2.7 percent in 1981, and 3 percent in 1986) and that the total cost of Medicare be paid out of general revenues.

Among the outstanding business, industrial, insurance leaders and social security experts who supported general revenue financing were the following:

1938 Council:

- Marion B. Folsom, Treasurer, Eastman Kodak Co.
- Walter D. Fuller, President, Curtis Publishing Co.
- Jay Iglauer, Vice President and Treasurer, Halle Brothers Co.
- M. Albert Linton, President, Provident Mutual Life Insurance Co.
- E. R. Stettinius, Jr., Chairman of the Board, U.S. Steel Corp.
- Gerald Swope, President, General Electric Co.
- J. Douglas Brown, Princeton University
- Henry Bruere, President, The Bowery Savings Bank
- Paul H. Douglas, University of Chicago
- Edwin E. Witte, University of Wisconsin

1948 Council:

- Edward R. Stettinius, Jr., Rector, University of Virginia
- J. Douglas Brown, Dean of the Faculty, Princeton University
- Malcolm Bryan, Vice Chairman of Board, Trust Co. of Georgia
- Adrien J. Falk, President, S & W Fine Foods, Inc.
- Marion B. Folsom, Treasurer, Eastman Kodak Co.
- M. Albert Linton, President, Provident Mutual Life Insurance Co.
- S. Abbott Smith, President, Thomas Strahan Co.
- Delos Walker, Vice President, R. H. Macy & Co.

Long-Range Aspects: Decoupling

There is general agreement on the necessity of decoupling the provisions enacted in 1972. In decoupling the benefits I strongly urge you not to reduce the existing old age benefit replacement rates as has been suggested in some quarters. One argument that has been advanced for a "simple" decoupling which would reduce the existing replacement rates is that there would be a substantial reduction in the cost of the program. But this result would simply open up the system to other proposals. Such a simple decoupling is too simple for political reality. Moreover, President Carter campaigned on retention of the existing replacement rates. It would be unwise to tinker with existing replacement rates and open up a new set of anxieties for the millions of aged persons as replacement for their present anxieties.

Eligibility Test for Dependents' Benefits

The U.S. Supreme Court in the *Goldfarb* decision ruled that the requirement for proof of dependency of a male spouse or widower was invalid when there was no comparable dependency test for the female spouse or widow.

There are three general ways to handle this situation:

1. Continue to apply the present law without any dependency test for either male or female spouses. This will add additional costs to the system. If this policy were to be continued consideration should be given to paying these unanticipated costs from general revenues. I do not favor this alternative.

2. Provide for a dependency test for both men and women spouses. This will increase administrative costs and payments in many cases primarily where a woman is the spouse or widow.

3. Request the Social Security Administration to present a plan for taking into account a retirement or pension payment under a federal, state or local public plan which is not supplementary to the basic social security system.

Where the male spouse receives a pension from a public plan which is a substitute for the basic social security plan, such pension should be treated as if the pension was a social security benefit and under existing law the individual receives whichever is the higher. This policy would also encourage coverage of federal, state, and local public employees who would then not have this dual benefit provision apply to them.

Some Related Issues

Raising the rates and the maximum earnings base on employees and employers may encourage state and local governmental units to withdraw from the system. I urge that coverage of state and local employees be made mandatory under the program. Moreover, federal civilian employment should be included under the system (just as military service is covered). I hope the Advisory Council will present recommendations on these matters.

Conclusions

The financial problems facing the system can be divided into three time periods:

1. The short-range problems of the next year and the next three-to-four years. These are immediate, pressing problems which necessitate legislation this year.
2. The middle-range problems of the period some ten to 25 years ahead. It would be desirable to try to meet some of these problems as soon as possible.
3. The long-range problems of the period 25 to 75 years from now. Part of this problem must and can be resolved immediately by "decoupling" the price-wage benefit formula and thus substantially reducing the long-run cost of the program.

The package plan submitted to you by the President aims to do something about each of these. I believe that is highly desirable. The tendency of the press to characterize the situation facing social security as "bankruptcy" has created anxiety and worry among the 33 million beneficiaries and the 100 million contributors. To the extent that Congress can resolve both the shorter and longer problems at this time, it would be an important contribution to restoring public confidence in the program.

There are other changes which need to be made in the program such as removing discrimination against working women and some divorced women, and financing longer-range costs on a more equitable basis. But first things must come first. A prompt decision by Congress to rectify the current financial difficulties will enable an Advisory Council on Social Security, required by law to be established by the Secretary of Health, Education, and Welfare, to make the studies and recommendations during the next 18 months which, if past experience is any guide, will help to sort out the innumerable and expensive options and present some consensus on next steps which so vitally affect the economy and the private sector.

Social Security is a large and growing enterprise. Cash expenditures under the program are estimated to reach $100 billion in a year or so. Such a large program should in my opinion be placed under a nonpartisan Board as it was during the formative period 1935–46. Legislation has been introduced in Congress to accomplish this objective: S. 1194 by Senator Frank Church and H.R. 5900 by Representative Charles Vanik, co-sponsored by a number of other influential members. Social Security should be removed from any implication that it may be utilized for any partisan political objective or any economic or fiscal theories or the unified budget. The Board of Trustees which submits the actuarial and financial reports should be broadened to include two nongovernmental persons.

Despite specific financial, constitutional, managerial, and policy problems, social security is still one of the most successful, efficient, and acceptable governmental programs initiated in the past 45 years. Its present shortcomings should not be used to perpetuate myths about the failure of "all" social programs.

Senator BYRD. Our next witness is Mr. Robert Ball, former Commissioner of the social security system and currently senior scholar at the Institute of Medicine for the National Academy of Sciences.

STATEMENT OF ROBERT BALL, FORMER COMMISSIONER OF SOCIAL SECURITY AND SENIOR SCHOLAR, INSTITUTE OF MEDICINE, NATIONAL ACADEMY OF SCIENCES

Mr. BALL. Mr. Chairman, I have a very long statement here. With your permission, I would like to have it included in the record, and I could, then, perhaps read some parts of it and summarize others.

I find myself, Mr. Chairman, a little bit at a loss in making sure that I use the time of the committee to the best advantage and not repeat the same discussion that you had with Mr. Cohen. Perhaps the best way to start is to say that I find myself less flexible than he is, and I support somewhat more completely the individual recommendations that the administration has come up with.

I have struggled for some time with this problem of how best to meet both the short- and long-run financing problems of social security, and there are lots of alternatives—no question about that. But it is my conviction that the administration has come up with a well balanced plan that does an extremely good job of meeting not just the shortrun problem but of producing an excess of income over outgo each year for the next 35 years and in addition to that, reducing the long-range actuarial imbalance from the 8.2 percent of payroll it is now estimated to be to less than 2 percent. All of the remaining deficit would occur after the end of the next century.

I would like to testify, Mr. Chairman, primarily, on the reasons why I believe the administration plan is worth the committee's support. Of course, there can be modifications in it, but basically it seems to me that it is a very sound plan.

Now, the short-range problem, as the committee knows, arises primarily because high unemployment rates have reduced income at the same time that benefits have had to be increased to make up for the rising cost of living.

The long-range problem arises from two factors: one, an automatic adjustment provision which can result in protection for current workers rising at a faster rate than average wages; and, two, because of an aging population, an expected decline in the proportion of people paying into the system in the next century as compared to those taking out.

The first part of the administration's proposal would "stabilize the replacement rate"—that is, the relationship of benefits to recent earnings. This change cuts the actuarial deficit in half. It seems to have such widespread support that there has been little discussion of it. It is the same plan basically as Senator Bentsen's bill of last year and the year before. The Ford administration introduced a similar proposal. It has the support of the insurance industry and other business groups, and of labor, and of senior citizens. But in spite of this widespread support, I think it is worth spending a little time on the proposal because you will have before you a different recommendation of a consultant group appointed by the Congressional Research Service. This group recommends a declining replacement rate as the major part of their solution to the long-range financing problem.

This seems to me an unwise solution. Over the years, ever since I have been connected with the social security system, we have tried

to operate on the theory that whatever level of benefits was decided on—in terms of the relationship of benefits to wages—that the same relationship would be more or less continued on into the future. This has been true at least since the days of the 1948 Advisory Council. And the financing of the system has been set up with this objective in mind.

If you start assuming that you are not going to keep social security up to date in terms of the so-called replacement rate—the relationship of benefits to recent earnings at the time people retire—you make the program look very inexpensive.

As a matter of fact, if you take the so-called "simple decoupling plan" that has been mentioned, the system is not in any long-range actuarial trouble at all. It turns out to have a huge actuarial surplus of 3.8 percent of payroll. This is the result of keeping benefits up to date with prices for those on the rolls, but letting the benefit table in the present law stay the same for those people who are still contributing. As wages rise, benefits at the time of retirement become less and less significant and you end up with a system in the next century that pays benefits equal to only about 10 percent of what the worker has been getting. In other words you end up with a completely useless system.

But if you make cost estimates on that basis—assuming you were going to have static benefits but rising wages—you make the system look very cheap.

Then as a matter of fact, the system is not allowed to deteriorate. The Congress intervenes to keep the benefits up to date with rising wages and the earlier cost estimates turn out to have greatly understated the cost of the system. This situation makes it very easy to move into overcommitments. I think this is a dangerous concept from the standpoint of conservative fiscal responsibility for the program. In addition, such an approach causes concern in private pension planning because no one knows exactly what is going to happen. The uncertainty would also be a matter of concern to young workers now contributing.

To my mind, it was a great victory, a very important advance in social security to adopt in the 1972 amendments an automatic provision that kept the benefits up to date, not only with prices for those on the rolls but with rising earnings for the people who are still contributing.

This is what had been done on an ad hoc basis by individual legislative action before 1972, but in the 1972 amendments, the intention was to make this result automatic.

What went wrong is not the objective. That is a sound objective—to have people get in the future the same proportion of their earnings as people who are retiring today.

What was wrong was the estimating assumptions. Instead of assuming, as was done at that time, that wages and prices would move as they had during the previous twenty years—assumptions which would have resulted under the automatic provision in a more or less constant replacement rate—it now seems much more reasonable to project much higher rates of inflation for the future.

I agree with this, but when you project into the future high rates of inflation and comparably high increases in wages, and you apply

these new assumptions to the automatic provisions as they are now written, you get a situation which is completely unacceptable. You get a situation where benefits are rising, not as wages rise—which is a desirable objective in my view—but benefits rising much faster than wages, so you get people in the next century theoretically getting benefits that are higher when they retire than any wages they had ever earned. That is obviously contrary to the intent of the amendments, contrary to the object of the program, and it has to be changed.

My suggestion is that in making the change you do what both the Carter and Ford administrations have proposed and relate the benefits to indexed wages so that benefit protection keeps up to date with rising wages for people still contributing, but does not exceed increases in wages. This change cuts the actuarial imbalance in half.

The alternative is to change the system so that you have a declining replacement rate. You can balance the long range cost very easily by just promising people in the future—instead of 45 percent of their recent earnings, as the worker earning average wages now gets—only 20 or 30 percent. The consultants report says 23 or 24 percent.

A declining replacement rate makes the system look cheap, but in practice it understates the real cost. It will not be a real solution, because the protection will be kept up to date on an ad hoc basis.

I am spending so much time on this point because it is my impression that few other witnesses have addressed this issue in detail.

Also, I would like to stress the long-range cost aspects of the system in my discussion with you, although I would also be glad to respond to questioning about the short run. But again, it seems to me the major focus has been on the next 5 years, which is very understandable. At the same time, it seems to me terribly important that the remedies adopted not be focused just on a relatively short-term solution. That will not be enough to restore the confidence of the country in the financing of social security.

The administration's proposals carry the system up to about the year 2010 and then leave, in terms of the present deficit, a relatively small deficit—1.9 percent of covered payroll. I would urge that their recommendations that are designed to carry this system all the way into the next century be a part of your plan. Moving the contribution rate increase of 2011 to 1985 and 1990 is an important way of reassuring people about long-range financing.

I would also like to turn your attention to the question of whether we ought to be concerned about the remaining 1.9 percent of payroll deficit. Mr. Chairman, I think that we should be concerned. I think that the possibility of there being a deficit in the next century—even after all of these things have been done that should be done now to carry us through the next 35 years—is a real one.

The most important part of the remaining problem is related to the question of the participation of older workers in the labor force. We know for certain—there just is not any doubt about it—that we are going to have a very large increase in the number of older people in the next century.

Senator Danforth, it is not so much that there is a steady increase from now on. What happens is that there is a relatively small increase

in the number of aged between now and the year 2005. Then, when the baby boom generation reaches retirement age, in about a 20-year period, we get a huge increase in the number over 65 all at once. The number leaps from about 31 to 52 million in a period of about 20 years. Such a sudden and major increase is quite certain.

What is uncertain is the size of the work force, the group that are paying in, and if that, of course, grew proportionately there would be no social security population problem in the next century, but the chances are that the age group 20 to 64 will not grow proportionately. The chances are that the fertility rate will not rise above replacement rate levels—the 2.1 children per woman adopted by the trustees in their last report. Under these circumstances we will have a decline in the number of 20-to-64-year-olds just at the time in the next century when we have this huge increase in the number over 65.

What possibly can be done about the problem? This is a fundamental economic question, not just a social security question. If these are the demographic facts, whether we try to support the elderly entirely through private pensions, or old age assistance or SSI or children taking care of their parents, there is no way out of the fact that, with this changed population distribution, more of the goods and services produced in the next century will have to go to the elderly.

It seems to me that what we need to be thinking about between now and then is how to develop policies that will encourage rather than discourage the participation of older people in the labor force. We do not have to think of a fixed group of workers age 20 to 64. As we consider how to support an adequate social security system, private retirement benefits, health insurance for the elderly, it is a very different matter if we assume people will retire on the average at 65 or 68, or if we assume they are going to retire at 60 or below.

The basic issues involved in the employment of more older peoples—modifying the institutional factors that lead to early retirement, modifying concepts of compulsory retirement, the ability of Federal employees to retire at a very early age and draw full pensions without reduction—require some thinking about now. It is very hard to get action in this area. It is not a big problem now. It will be a big problem 20 or 30 years from now.

Mr. Chairman, I think I have selected those things from my statement which are not duplicative of Mr. Cohen and other witnesses that you have had. I will just conclude by reading the conclusion of my statement and then I will be very happy to respond to any inquiries that the committee may have.

I say in conclusion: Now, what does this all add up to? I believe the wise policy would be to take action now that would fully support the system over the next 35 years or so. The administration's plan is the best plan I have seen for accomplishing this purpose. The actions also reduce the long-range actuarial imbalance to an estimated 1.9 percent.

To help further reduce this estimated imbalance, I believe we should work toward policies that promote employment opportunities for the handicapped and for older people.

Whether after these actions an imbalance would still develop in the next century is uncertain. We will know much more about that 10

or 15 years from now after we have had a chance to observe the developing trend of fertility rates, disability rates, and other uncertain factors that govern long-range costs.

In any event, because of the possibility of some remaining long-term deficit, I believe it would serve to underline the Government's determination to meet all future social security obligations as they fall due to put back into the Social Security Act the guarantee that was in the act from 1944 to 1950 as follows:

> There is also authorized to be appropriated to the trust fund such additional sums as may be required to finance the benefits and payments provided in this title.

The administration plan carries the system for 35 years. This kind of guarantee, I think, in addition, would be a useful reassurance.

Attached to my statement are the demographic figures that go to some of the points you were discussing with Mr. Cohen—the fact that the number of children declines under the same assumptions that result in fewer people age 20 to 64, and that therefore the total burden of support on active workers in the next century is not as frightening as if you look just at the aged alone.

Thank you very much, Mr. Chairman.

Senator NELSON. With respect to utilizing the 1944–50 Vandenberg statute or adopting the administration proposal on protecting the fund against excess unemployment beyond 6 percent by using the general fund contribution, you are well aware that many people are concerned that once you establish the principle it will go beyond that, and, when additional benefits are added, you put pressure to finance them out of the general fund rather than increasing social security taxes.

Mr. Cohen made the point, as you have, that it gives some assurance to the beneficiaries of the integrity of the fund, and I am not saying that is unimportant. But I can't imagine the situation wherein the Congress, with or without previous assurances, would not go to the general funds if the integrity of the social security system were in jeopardy.

If we had 10 percent unemployment and a disaster situation confronted the trust fund, and it would be unwise to dramatically increase the taxes on employer and employees, Congress would not let the trust funds deplete completely

Why bother with it if, in fact, the assurance is there already, and when establishment of such a principle brings with it the risk of future attempts to use general funds to pay for increased benefits.

I think that in the beginning some of the original designers of the plan argued for one-third, one-third, one-third. Is that not correct?

Mr. BALL. Yes.

J. Douglas Brown, who worked on the staff that helped develop the social security program before it became law—he is now dean of the faculty emeritus of Princeton—had a letter in the New York Times just recently where he pointed out that the 1938 Advisory Council argued for a long-range one-third, one-third, one-third division.

My own view, Mr. Chairman, at the moment, for the time being, is that there are so many other demands on the general funds of the Government, so many other needs for general funds that personally

I think that it would be better to solve social security's financing problems without resort to the use of general funds other than in the sense of a residual guarantee. I don't believe you have to appropriate money or actually use general revenues.

The only point of the administration's proposal, as I understand it, is to issue bonds to the funds that would make up for the loss of income because of the excess of unemployment beyond 6 percent in the limited period of 1975, 1976, 1977, and 1978.

Their estimate is that that would be about a $14 billion promise to pay. It would never need to be used if everything works out all right. It is a reassurance to people that the fund is there if needed, but it is not an appropriation. The bonds would be cashed in only if the estimates were way off and the fund dropped to below $14 billion.

The administration recommends that the next Advisory Council look at the question of whether that sort of device should become a permanent part of law. To me, that is very similar to writing back into the law a general underwriting of the program in the event that the actions designed to finance social security do not quite work out.

But I am for putting into the law itself the provisions that raise the money to pay for the next 35 years. I would limit the role of general revenues, at this point, to an underlying guarantee—and to the administration's proposal for some $14 billion on bonds—which you say is probably not realistically necessary—the Congress would use general revenues in any event if they were needed. ButI think that it would be reassuring to people to be able to point to it in the law.

Senator NELSON. You would do it, or you would have a new Congress?

Senator CURTIS. Would you yield for me for a unanimous consent request?

Senator NELSON. Yes.

Senator CURTIS. I must leave. I am sorry, Dr. Ball, that I have to leave. I cannot be here for Dr. Campbell's testimony. She is one of the very fine accomplished women in our country and I would like to ask unanimous consent that I might submit some questions sometime later for Dr. Campbell based upon her testimony, so she might respond.

Senator NELSON. Surely.

As a matter of fact, I think that we will have questions that we would like to submit to the expert witnesses once we have completed our hearings. In fact, we may wish to ask you back to discuss some details and other questions you raised, such as the disability of benefits question.

There are some problems there that we ought to address and I would hope that you would all be available to make your own recommendations on those questions and to comment on the administration proposal.

Mr. BALL. I would be very happy to, Mr. Chairman.

Senator NELSON. Do you have any questions, Senator Danforth?

Senator DANFORTH. I just have one.

If you are trying to encourage people that are over 65 to continue to work, you do not assist that goal by taking away social security benefits if they make over $3,000 a year.

Would removing the earnings limitation do more harm to the soundness of the system than helping it?

Mr. BALL. I do not think that that would help, Senator Danforth.

Let me say first that the problem that I spoke about is a problem for the next century. I think we have to plan now how to meet it. We have to prevent the extension of policies like compulsory retirement age and these other institutional factors that make it seem acceptable for people to retire at 60 or 62, but that is because the real problem is going to occur down the road 2005, 2010 and so on.

You have a very difficult and delicate balance to work out on the question of the so-called retirement test that you raise. We have two objectives that are somewhat conflicting and as so often happens in public policy, there is no one right way to go.

One objective is to conserve the funds of the social security system for people who have had a loss of income. The system is "income insurance." You want to make up for part of their loss of earnings on retirement. You do not want to just give a bonus to the people who are lucky enough to keep a job past 65. If you were to abolish the retirement test, then having more people work in old age would not be a way of saving much money. You would be paying them benefits while they were working anyway.

On the other hand, an equally valid objective is to have social security interfere as little as possible with the individual's motivation to work. I think the present test does quite well on balancing these two things.

You can earn quite substantial amounts under social security today and still get some retirement benefit. There is a $1 deduction in benefits for $2 above the $3,000 exemption. Even a person earning as much as $10,000 a year can get a few hundred dollars in benefits.

Senator DANFORTH. Has any connotative analysis been done on the disincentive effect of people continuing to work by the retirement?

Mr. BALL. I am not aware of anything that is worthy of that label.

Senator DANFORTH. I would just question, not seeing any figures, your conclusions. Obviously you cannot extrapolate from individual experiences that you have great sociological principles, but I doubt that it does not have a very substantial effect of providing a disincentive to continue working.

I just know too many older people who, at the age of 65, want to continue working and feel that there is absolutely no point in it.

Mr. BALL. I would say it does have some disincentive effect. I did not mean to give the impression that it did not.

I meant to say that we are trying to balance two things. I think the fact that only $1 in benefits as deduction for $2 in earnings above an exempt amount means that you always gain more by working than not working. That does not mean that you would not have even more of an incentive if you continued at your regular job after 65 and got social security too.

One of the things that always surprises me in these arguments is that nobody makes the same point about private pensions. It is a disincentive to continue at your job as an official of the U.S. Government if you can only get a pension by retiring. Of course it is a disincentive.

You would not retire unless there were a pension there. But in private pensions and in government career plans it is always assumed that the pension will be payable only if the individual retires.

Senator DANFORTH. I think it is entirely different. It is different for a private employer or a private employee's pension system, in effect, to tell people that they should move on or retire than for the Government of the United States to tell people that they should retire at age 65.

Mr. BALL. Let me go at least part way with you, Senator.

I believe one of the worst things about the present retirement test is that it seems to say to people—even after they have retired from what may have been their regular job—the Government does not want them to work, there is a penalty for work. That is the impression that people have.

There is in the law now a very small increment for work after 65, 1 percent a year more in benefits is paid for each year that you work. I would raise that to 4 percent, so you would tell people they are not going to get their benefits at the same time they are working, but because they work longer, when they do retire they will get a higher benefit, and a significantly higher benefit.

I think that might be helpful.

Senator DANFORTH. It may be worth thinking about. I think the present system is unfair and just part of our national mentality, telling people when they reach the age of 65, we really want you on the shelf. That is what Congress has done by the present system.

Mr. BALL. Think about that increment.

Senator DANFORTH. Thank you.

Senator NELSON. Thank you very much. We appreciate your taking the time to come.

[The prepared statement of Mr. Ball follows. Oral testimony continues on p. 121.]

STATEMENT OF ROBERT M. BALL

Mr. Chairman and members of the committee, my name is Robert Ball and I am now a Senior Scholar at the Institute of Medicine of the National Academy Sciences. From April 1962 until March 1973, I was Commissioner of Social Security and prior to that served for approximately 20 years in various positions in the Social Security Administration and its predecessor organization, the Social Security Board. I am testifying today as an individual, and my opinions do not necessarily represent those of any organization with which I am associated.

SUMMARY OF MY POSITION IN SUPPORT OF THE ADMINISTRATION'S PROPOSALS

The social security system has both short- and long-range financing problems that call for early congressional attention. The short-range problem arises primarily because high unemployment rates have reduced income at the same time that benefits have had to be increased to make up for the rising cost of living. The long-range problem arises from two factors: one, an automatic adjustment provision which can result in protection for current workers rising at a faster rate than average wages; and, two, because of an aging population, an expected decline in the proportion of people paying into the system in the next century as compared to those taking out.

President Carter has submitted several recommendations to the Congress which taken together assure that annual income to social security will exceed outgo well into the next century. This plan also reduces the estimated long-range—75 year—imbalance from 8.2 percent of the payrolls covered under social security to less than 2 percent.

The first part of the proposal would "stabilize the replacement rate"—that is, the relationship of benefits to recent earnings. What this means is that workers now young would get benefits at the time of retirement that were the same proportion of their recent earings as is true of workers retiring next year—roughly, 56 percent for workers who have been earning the Federal minimum wage, 45 percent for those earning average wages, and 33 percent for the higher paid. Unless this change is made—under the wage and price assumptions now being used to project the cost of the system—benefits in the long-run future would be a higher proportion of wages just before retirement than is true now, a clearly unintended result of the automatic provisions added to the law in 1972. Under the Carter proposal, as at present, after a person starts getting benefits, those benefits would be kept up to date with prices. This recommendation for stabilizing replacement rates was also supported by the Ford Administration, by the 1974–75 Advisory Council on Social Security, by labor and senior citizens' groups and by business and insurance groups. The proposal reduces the long-range actuarial imbalance in the system by one-half to a little over 4 percent of payroll.

The rest of the Administration's proposals are aimed at raising the money to meet the remaining deficit over the next 35 years and to cut in half the actuarial imbalance that is estimated to remain after replacement rates have been stabilized. All of the remaining deficit, incidentally, is estimated to occur after the year 2010.

There are a limited number of possibilities. One can increase the contribution rates on all employers and employees; it would take an immediate 1 percent increase in the contribution rate on employers and the like amount on employees (more if postponed) to reduce the deficit as much as the administration's proposals do. Another possibility is to very substantially raise the base for which the social security contribution rates are applied ($16,500.00 this year). Thirdly, one can turn to general revenues for a considerable part of the support of the system. What the President has recommended seems to me to represent a good balance of the various possibilities. Those who object to these proposals should be required to state how they would restore public confidence in social security financing, a goal which requires not just getting through the next few years, but making sure that the money is there when it is time for today's contributors to retire.

Beyond the proposal for stabilizing replacement rates, the Carter plan has three major parts:

1. Taxing Employers on Their Entire Payroll.—During the period 1979–85 the base on which contribution and benefits are computed would rise in four steps by $2400 more than under present law for workers. For employers, however, the ceiling would be gradually removed. While this represents a change from the nearly equal employer-employee financing that has been characteristic of our social security system, it is not a basic departure from social insurance principals. There are many foreign systems in which the employers pay a larger part of the cost than the employees[1] (including countries that apply the employer's contribution rate to the entire payroll).

While it is very important to the preservation of the self-help character of social security that workers make a significant contribution toward meeting the cost of their protection, there is nothing magic about equal shares. The employer's tax does not need to be thought of as being tied to the protection of any particular worker but can be thought of as helping to support the system as a whole.

The administration's proposals change the division of financing from the present division of about 48 percent by employers, 47 percent by employees, and 5 percent by the self-employed to about 50 percent by employers, 45 percent by employees, and 5 percent by the self-employed. The government now pays, for specially defined purposes, about 1 percent of the cost of the system and would continue to pay about this percentage under the administration's plan. (This amount is so small that it is lost in the rounding of the figures given previously.)

[1] Including Belgium, Denmark, France, Italy, Norway, Portugal, Spain, Sweden and Great Britain.

As compared to the more traditional approach of raising the base equally for employees and employers, with consequent additional increases in benefits for higher paid employees, the Administration's plan leaves a greater role for private insurance, private savings, and private pension plans.

2. The "Counter-Cyclical" Use of General Revenue.—Under the plan, payments from general revenue would make up for the loss of social security income caused by unemployment in excess of 6 percent. If the proposal becomes a permanent part of the law (the Carter Proposal is limited to the 1975–78 period) it would allow the maintenance of lower reserve levels than would otherwise be the case because additional general revenue payments would automatically cushion the decline in reserves during the recession periods. This is by no means a proposal for a broad-based infusion of general revenues, and in fact would have no effect at all except on the size of the reserves unless some future recession caused the reserves to drop so low that it was necessary to cash the bonds which under this plan would have been issued to the trust funds.

3. Contribution Rates Would Not be Increased Above the Levels Provided in Present Law but There Would be Some Redistribution of Income Among the Various Social Security Funds and the 1 Percent Rate Increase Now Scheduled for the Year 2011 Would be Moved Up.—Because of the larger payroll to which contribution rates would be applied and becaues of the controls proposed on increasing costs of hospital care, part of the scheduled increase in rates for the hospital insurance program could be moved over to the cash benefits program. In addition, the 1 percent rate increase now scheduled for 2011 in the cash benefit program is rescheduled for a one quarter of 1 percent increase in 1985 and a three quarter of 1 percent increase in 1990. The self-employed rate would again be set at 1½ times the employee rate; this is the relationship established in 1950 when the self-employed were first brought into the system and maintained until 1972.

In summary, the Administration's proposals would stabilize social security benefit levels in relation to wage levels, provide for annual income in excess of expenditures for the next 35 years, maintain reserve levels which when taken together with the counter-cyclical proposal for the use of general revenues would be sufficient to weather a mild to serious recession, and reduce the long-range actuarial imbalance from over 8 percent of payroll to less than 2 percent.

SUMMARY OF THE EFFECT OF THE CARTER ADMINISTRATION PROPOSALS OVER THE NEXT FIVE YEARS

The Carter Administration proposals during the period 1978–82 would raise $35.1 billion in additional taxes: $28.2 billion for the cash benefit program, and $6.9 billion for hospital insurance. The breakdown is as follows: $30.4 billion for the proposal to tax the entire payroll of employers, $3.5 billion for the increase in the base for employees, and $1.2 billion for the increase in the contribution rates for the self-employed.

These figures are divided by year as follows: in 1978, 0; in 1979, $3.2 billion; in 1980, $7 billion; in 1981, $11.8 billion; and in 1982, $13.1 billion.

Since, about two-thirds of the covered payrolls are paid by corporation and since the corporation tax on the average is about 43 percent, the additional burden on taxpayers in the next three years when there is need for particular concern about sustaining the economic recovery is 1978, 0; 1979, $1.8 billion; 1980, $4.3 billion.

In addition to the $28.2 billion increase in taxable income for the cash benefit program, the cash benefit trust funds are helped in other ways by the plan. There is $3.4 billion in reduced expenditures (another $10.2 billion in reduced expenditures for hospital insurance); $16.1 billion in transfers from hospital insurance; $8.8 billion from added interest (another $0.6 billion for hospital insurance); and $11.9 billion (another $2.2 billion for hospital insurance) in bonds to the trust funds (future promises to pay if needed). This is a total of $40.2 billion which when added to the $28.2 billion makes the cash benefit trust funds during the next five years $68.4 billion better off than they would be under present law. The hospital insurance fund for the period would be about $3.6 billion better off than under present law.

INTRODUCTION

Mr. Chairman, I would now like to back up and give a rather full statement concerning the present situation in social security financing and what steps I think ought to be taken to meet the problem.

Social security today is of major importance to just about every American family. Practically every American is either a beneficiary, a contributor building future protection, or is the dependent of a contributor. Today 93 percent of the people 65 and older are eligible for social security benefits. Ninety-five out of one hundred young children and their mothers are protected by the life insurance features of social security, called survivors' insurance. Four out of five people in the age group 21 through 64 have protection under social security against loss of income due to severe disability. More than 33 million people, one out of seven Americans, receive a social security benefit each month. About 108 million people will pay into the program this year.

The government through social security has promised future protection to all these people in return for specific earmarked contributions, or premiums, paid by the workers of the country, their employers, and the self-employed. I have no doubt that these promises will be kept, but, as you all know, concern about the financial security of social security is growing among the millions and millions who must depend on the system. An erosion of public confidence is taking place, and unnecessarily. Although there *is* a short-fall in social security financing under present law, it is correctable. Steps can and should be taken now to restore the financial integrity of the system and to assure people that their social security protection is safe.

THE NEXT FEW YEARS

Social security paid out $3.2 billion more than it took in 1976, and will pay out about $5.6 billion more than it will take in this year. This would not be a cause for concern if full economic recovery would restore the program to balance. The Trust Funds exist for the purpose of seeing the program through short periods of recession. However, a return to full employment and to much lower levels of inflation, while, of course, very helpful to social security financing, will not alone be enough to fully solve social security's financial problem. There would remain a middle range problem over the next 25 years or so and the possibility of a longer range problem in the next century.

THE BACKGROUND OF THE SOCIAL SECURITY FINANCING PROBLEM

Before discussing specific proposals for action, let me remind you how we got to where we are. When the social security amendments providing for automatic cost-of-living increases were signed into law in 1972, the system was thought to be adequately financed. There is no truth to the notion that Congress has been willing to vote benefits but not financing. Congress has been very responsible about social security financing. The 1973 reports of the Boards of Trustees issued shortly after the 1972 amendments showed an imbalance over the 75 years for which estimates are made of about one-third of 1 percent of covered social security payroll, as compared with an estimate of exact balance at the time of the 1972 legislation. (What is meant by this is that an increase in the contribution rate of one-sixth of 1 percent for the employee and a like amount for the employer would have brought the system into exact balance.) Revised estimates made in the fall of 1973 showed an increase in the imbalance—to over three-fourths of 1 percent. In the 1973 amendments, the Congress not only speeded up the cost-of-living benefit increase for 1974, but also brought the long-range imbalance down to a level of about one-half of 1 percent of covered payroll. This was an imbalance of about 5 percent relative to the cost of the whole program over the 75-year period. This relatively minor degree of imbalance was considered acceptable by the Congress, considering the major uncertainties attached to such long-range estimates.

Moreover, under the estimates it was expected that, in any event, income would exceed outgo year by year far into the future, and that any possible adjustments could be made well before the time they were needed.

It now appears that because of the rapid rate of inflation in recent years which caused increases in benefits under the automatic provisions, while at

the same time unemployment has caused a drop in estimated revenues, there will be a need for more income to the system during the rest of this century than had previously been thought to be the case. A contributing factor in this deficit is that the disability insurance program is now estimated to cost substantially more than it was previously estimated to cost.

As already indicated, the deficit caused by the recession does not disappear with economic recovery: All benefit payments in the future will be higher because of the inflation of the past, and the system cannot make up for lost revenue because interest on the shrunken reserves will be lower than previously expected.

WHAT SHOULD BE DONE

1. Change the automatic provisions in present law so as to stabilize the replacement rate

The introduction of the automatic provisions in social security in 1972 was a major accomplishment. Beneficiaries are now protected against inflation and protection for current contributors is automatically kept up-to-date with changes in wages and prices. There is, however, a problem in the design of these automatic provisions. As they are written, under some wage and price assumptions benefit protection rises proportionately as wages rise, thus keeping up-to-date with the level of living as originally expected; under other assumptions, in the long run, the benefit protection may rise less than wages rise; or, under other assumptions—such as those assumed in the latest reports of the Boards of Trustees—much more than wages rise, resulting in the completely unrealistic situation in the 2030 to 2050 period of many people then becoming eligible for social security retirement benefits that are higher than any wages they ever earned. It all depends on the happenstance of how wages and prices move. (When these automatic provisions were adopted, it was assumed that the wage and price pattern of the previous 20 years would continue, and under those patterns, benefit protection over the next 25 years would have increased approximately with wages. But under recent assumptions this is not the case.)

The automatic benefit provisions should be changed in such a way that benefits paid in the long-run future are the same proportion of recent earnings for those who retire at that time as benefits are today for those retiring today. In other words, the "replacement rate" should be stabilized. This means that benefit protection for contributors would be guaranteed to keep up-to-date with increases in wages but not allowed to exceed such increases. Once on the rolls, the purchasing power of the benefit would be guaranteed as under present law.

Such a change in the automatic provisions is desirable, in any event, because it removes the gamble for current contributors and provides a level of protection they can count on. In addition, because of the specific wage and price assumptions which have been used in recent cost estimates, such a change would also have the effect of reducing the long-range (75-year) actuarial deficit by about one-half.

Stabilizing future social security replacement rates and assuring that social security benefits for current and future workers when they become beneficiaries would replace the same percentage of pre-retirement earnings as workers retiring today is a fundamental element of President Carter's proposal for rebuilding public confidence in the financing of the system. This proposal is squarely in line with the intent of Congressional action over the years, the 1971 Social Security Advisory Council's recommendation to increase benefits automatically, the 1975 Advisory Council's recommendation to "decouple" the benefit structure, the proposal made by Senator Bentsen and the "decoupling" plan recommended by the Ford Administration in 1976. The proposal has widespread support among business, insurance, organized labor and senior citizens groups.

Mr. Chairman, at this point, perhaps it would be worthwhile to digress slightly in order to say why I do not believe that in changing the automatic provisions the Congress should give consideration to the possibility of reducing the replacement rates in present law. It is true, of course, that if benefit levels in the future were to be smaller relative to wage levels in the future, the system would cost less as a percent of cevered payrolls. In other words, the financing of the system could be balanced by the device of reducing benefits relative to wages, but it would be at the cost of making the social security

system inadequate for the young people contributing today. I bring this up because such a course has been suggested by a panel of consultants to the Congressional Research Service.

I believe this approach would be unwise. Present replacement rates are certainly not excessive, and the ratio of social security benefits to previous earnings more than anything else determines the income security of older people. Even in the long run, probably 50 percent of the people over 65 will be dependent on social security alone for a regular retirement income. Any reduction in social security replacement rates would surely mean inadequate protection for this group who will not have additional protection under private plans or career government plans, and probably also for many of those with supplementations. For others with supplementation, total protection could be maintained only if pension plans were substantially liberalized to make up for any cut-back in replacement rates under social security.

In many ways, the question of how best to modify the present automatic provisions may be the most important of the issues before you. Economic security is not a matter solely of having enough income to buy a minimum standard of living—a poverty or welfare standard—the same for all. It is also a matter of replacing sufficient earnings so that people in retirement, the disabled, or widows and orphans can, by a combination of social security and private protection, be able to maintain a level of living not too far below what they had when they were dependent upon earnings. Thus the test of adequacy in social security has to be primarily the level of replacement of past earnings. For those retiring next January, the replacement rate (the ratio of benefits to recent earnings) will be 56 percent for the single worker who has been earning the federal minimum wage and retires at 65, and 84 percent for the couple. For the worker earning the median wage for male workers, the replacement will be 45 percent and 68 percent respectively, and for the worker earing the maximum covered amount, 33 percent and 50 percent. "Stabilizing the replacement rates" means that approximately these replacement rates would be maintained on into the future. Under the consultant's recommendations previously referred to, the 45 percent replacement rate for the average worker retiring in 1978 would drop to 30 percent by 2010 and 25 percent by 2050. To bring this down to specific cases: A worker age 55 today earning the average wage will get a benefit of about $660 a month at age 65 under an approach that stabilizes the replacement rate. Under the consultant panel's approach, the same worker retiring at 65, ten years from now will get about $510 a month.

In my opinion, any of these proposals to reduce the replacement rate would constitute a major deliberalization of present law—a cutting back on the promises already made to people who have been paying into social security. For at least 25 years the implicit assumption in the way the program has been financed has been that benefit protection would be increased from time to time to keep up with rising wages, and contribution rates have been written into the law that, on the basis of the assumptions used, were approximately sufficient to make a constant replacement rate possible.[1]

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[1] As the Advisory Council of 1948–49 observed:

"In setting the contribution rates for the system the essential question is probably not 'What percentage of pay roll would be required at some distant time to pay benefits equal to the money amount provided in the Council's recommendations?' Rather it is 'What percentage of pay roll will be required to pay *benefits representing about the same proportion of future monthly earnings that the benefits recommended by the Council represent of present monthly earnings?*' [Emphasis supplied.] If past trends continue, monthly wage earnings several decades hence will be considerably larger than those of today, and benefits will probably be revised to take these increased wages into account. The long-range estimates presented by the Council, however, disregard the possibility of increases in wage levels and state the costs of the proposed benefits as a percentage of the pay rolls based on continuation of the wage levels of the last few years. If increasing wage levels had been assumed, the costs of these benefits as a percentage of pay rolls would be lower than those presented. Use of the level-wage assumption, therefore, has the effect of *allowing for liberalizations of benefits to keep pace with any increases in wages and pay rolls which may occur.*" [Emphasis supplied.]

The procedure described by the Council in 1948 was followed in making cost estimates and in setting contribution rates up to the time of the adoption of the automatic provisions in 1972 which were designed to guarantee by law what had previously been implicit.

This assumption was also reflected in the way ad hoc benefit increases were designed. For many years, whenever benefits have been increased, the benefit table in the law has been rewritten so that people on the rolls received flat percentage benefit increases—often a cost of living increase—while protection for those still contributing was increased by the some flat percentage. When combined with the increasing protection flowing from the higher level of wages to be expected in the future, such a change in the benefit table kept benefit protection roughly up-to-date with wages. When the automatic provisions were adopted in 1972, the same procedure was followed.

The objective of the 1972 amendments and the objective of the ad hoc increases made previously are valid objectives. What we know now is simply that given the current assumptions underlying the actuarial estimates—which seem more reasonable now than the assumptions previously used—the attainment of the objective is more expensive than it was originally thought to be.

Also there is a reason to doubt whether it would be prudent to adopt any kind of a plan for a declining replacement rate. If, in practice, protection under social security is not allowed to deteriorate but is kept up-to-date with wages on an ad hoc basis, then the approach of estimating the cost of the program as if there were going to be a declining replacement rate undertates the true commitments of the system. For example, what has been called a simple "decoupling proposal" in which benefits for those on the rolls are kept up-to-date with increases in the cost of living but benefit protection for those still contributing is not adjusted, shows that for the long run the present system has no financial problem but a major actuarial surplus.

If the costs of such a program are estimated for the long run, on the assumption of rising wages, the program, in fact has a large enough actuarial surplus to provide a 30 to 35 percent increase in benefits. But, of course, this is nonsense because the present increases are paid for out of the higher wages of the future and replacement rates in the next century fall to 10 percent or less. Additional ad hoc benefit increases would have relatively easy acceptance under plans with a declining replacement rate because the cost would not appear to be great. This is true because the estimates would assume in each case that the new level of benefits would not be kept up-to-date with wages.

This is the kind of situation that we have always tried to avoid. We have always assumed in the past, whether the changes were made on an ad hoc basis or whether under the automatic provisions, that increasing the replacement rates to any particular level was a commitment to maintain those replacement rates in the future. If we don't continue that assumption in the future, I think we will be in considerable danger of making over-commitments. Since the adequacy of benefits is a matter of replacement rates, it seems to me likely that an approach that assumes a declining replacement rate could well lead to excessive commitments, because under this approach the long run cost of maintaining the replacement rate would not be explicitly recognized.

2. The maximum amount of wages counted for benefits and contributions should be gradually increased more than provided for by present law

I do not favor rate increase beyond those provided in the present law unless, at the same time, the protection of the program is increased. A rate increase falls on all wage earners, low paid as well as high paid, and no one gets additional protection for their additional contributions.

Instead, I favor a gradual increase in the amount of earnings counted for benefits and contributions. Only the 15 percent of wage earners who have earnings above next year's maximum of $17,700 a year would pay more, and—over time—they would also receive more in benefits.

President Carter's proposal for four $600 step increases in the maximum earnings base for employees seems to me a good one. Although this does not result in much long range gain to the system if the entire payroll is taxed on the employer's side, it does help in short run financing and makes modest improvements in protection for higher paid workers.

3. Removing the maximum on the base to which the employer contribution rate applies

The employer's contribution does not need to be thought of as going to any particular employee but can be thought of rather as a resource for the system

as a whole. It is very important that workers pay a significant part of the cost of their own protection through deductions from earnings, but there is no particular reason why the employer share should not be somewhat higher. Taking the system as a whole, employers now pay about 48 percent of the cost and employees about 47 percent and the self-employed about 5 percent. Under this proposal, the shares would be shifted to about 50 percent by the employer and 45 percent by the employee and still 5 percent by the self-employed. The government's share would remain at about 1 percent where it is today. (These are rounded figures so they do not add exactly.)

4. Shift part of the scheduled increase in the hospital insurance contribution rates to the cash program

One important result of the proposed base increases is that they also provide substantial additional income for the hospital insurance part of medicare (HI). This increase in HI revenues helps make it possible, under the Carter administration plan to shift a part of future tax rate increases, now scheduled to go to hospital insurance, to the cash benefit part of social security instead. In addition, the implementation of controls on hospital costs would produce very substantial savings to the hospital insurance programs. Altogether under the proposal, out of the scheduled 1980 and 1983 hospital insurance rate increase, which total 0.45 percent for employers and employees each, 0.2 percent each would be shifted to the cash benefits program. This would help to provide additional revenues to the cash benefits program both in the short range and over the long range future. The hospital insurance program, because of the increase in incomes from the higher payrolls tax and because of the hospital cost controls is nevertheless left in a significantly better position than it is under present law.

5. The contribution rate increase of 1 percent now scheduled for 2011 should be made effective earlier

The present law contains a contribution rate increase of 1 percent scheduled for the year 2011, a rate increase which was designed to deal with the problem of a higher ratio of retirees to workers in the next century. The proposal would move part of that rate up to the point when, after the changes already indicated, the outgo of the system would otherwise once again exceed income. It is proposed that one-fourth of one percent of the rate go into effect in 1985 and three-fourths of one percent in 1990.

6. Appropriate reserved levels should be maintained

The social security trust funds currently represent about 47 percent of annual (1977) expenditures and this percentage is expected to decline over the next two years. Recent studies conducted by HEW have indicated that trust fund ratios of about 50 percent of the next year's annual expenditures would be necessary to sustain the program in the event of another serious recession, and thus avoid the need to raise taxes before economic recovery was properly under way. It is clear that the reserve would not have to be so high if during a recession—when income to social security falls off because of unemployment—there was a pledge by government to bolster the falling social security reserves. The administration believes that a 33 percent reserve fund would be sufficient with such a guarantee.

However, the specific recommendation of the administration at this time is simply for a one time use of general revenues to make up for the social security income losses because of unemployment rates in excess of 6 percent or more for the years 1975–78. The purpose is to avoid the higher contribution rates that would otherwise be necessary to build the present fund back up to a 50 percent ratio and keep it there. The present proposal is for a one time payment, with the idea that the statutory Advisory Council on Social Security that will be appointed later this year will study the idea and consider whether such a provision should be made a permanent part of the social security system. No appropriations need to be made for the purpose of this addition to the funds since the added bonds are essentially a promise on the part of the government to pay should the fund drop to the level where it would be necessary to cash in these bonds.

In my judgment, this proposal is not greatly different than a provision that was in the law from 1944–1950 as follows:

"There is also authorized to be appropriated to the trust fund such additional sums as may be required to finance the benefits and payments provided in this title."

7. The traditional relationship between the contributions made to the self-employed and the worker should be restablished

The rate to the self-employed was originally set at 1.5 times the employee rate as a compromise, recognizing that coverage at the same rate as the employee would be disadvantageous to the system as a whole, while a rate equal to the total combined rate might be an excessive burden for many self-employed persons. However, a limit of 7% on the self-employed contribution rate has been in the law for some time (they now pay at a rate of about 1.4 times the employee rate). Restoration of the full 1.5 contribution rate for the self-employed was recommended by the 1974–75 Advisory Council and is part of the administration's proposal.

8. Windfall benefits to husbands and widowers should be prevented

The principle effect of the March 1977 Supreme Court decisions granting benefits to husbands and widowers under the same conditions as those previously applicable to wives and widows (that is without a specific test of dependency) is to make eligible for social security benefits a substantial number of men who have worked for the federal government or for those state and local governments not covered by social security and whose wives have worked under social security. Very few of these men are in any real sense the economic dependents of their wives, and payment of benefits to them as dependents—in addition to paying them pensions earned in government employment—costs money and leads to unreasonable results. If the men were covered by social security as well as by the government retirement systems, the dual benefit provisions of the Social Security Act would almost always prevent them from receiving husbands' or widowers' benefits. In the absence of the most desirable solution, the coverage of all government under social security with appropriate modification of the government systems, the Social Security Act should be amended to prevent payment of benefits in the cases described. Any provision adopted would, of course, have to apply equally to wives and widows.

THE EFFECT OF THE PROPOSALS

The combined results of the administration's proposals—increases in the amount of earnings subject to contributions, shifts in the hospital insurance contributions rates, moving up the contribution rate already scheduled in present law, and stabilizing replacement rates would result in an excess of income over outgo over the next 35 years, and with the addition of the countercyclical proposal would maintain adequate reserves throughout this period. It would reduce the long range actuarial imbalance from over 8% of payroll to less than 2%. This would be accomplished without increasing the contribution rates over those already scheduled in present law.

I want to stress that two of the changes suggested for dealing with the financing problem are desirable in terms of benefit protection, really without regard to financing. The substantial improvement in financing is a by-product of improving program protection.

It is desirable through "stabilizing the replacement rate" to guarantee that benefit protection will rise as wages rise, but it is not desirable to have automatic provisions that could result in social security protection rising at a faster rate than wages. If such an improvement in the relative level of benefits is desired, it should be by specific congressional enactment. Increasing the amount of earnings counted for benefits and contributions would make the financing of the system more progressive, and would improve protection under social security for those called upon to pay more and who now have quite low ratios of social security benefits to past wages.

There are, of course, other possibilities for meeting the deficit. It would be possible to do it entirely by increases in the contribution rates. Another possibility would be to raise the wage base equally on employers and employees, but since benefits of higher paid workers would also be increased by the move, the base would have to be lifted almost entirely to reduce the long range actuarial deficit as much as taxing the entire employer's payroll does.

A still further possibility would be to introduce a substantial general revenue contribution into social security in the near future. Many foreign systems have such a government contribution in addition to deductions from workers' earnings and payments from employers. I would favor a contribution from general revenues in the long run if it turns out to be needed to meet the long-range costs of the present program or of an improved program. However, with all the other current pressures on general revenues, it seems to me best for now to meet the financing deficit in social security, without looking to general revenues for more than the residual guarantee function proposed by the Carter Administration—essentially a device for holding down the cost of building up the reserves.

THE EFFECT OF SOCIAL SECURITY CONTRIBUTIONS ON LOW WAGE EARNERS

I believe it would be a mistake to exempt low-income workers from social security contributions or to base social security financing on progressive income tax principles. Social security grew out of the efforts of people to help themselves. Its roots go back to contributory plans in the medieval guilds and to trade unions, fraternal orders, friendly societies, and insurance plans—self-help efforts. Although I support the use of general revenues for social security to finance part of the cost of the system in the long run, if needed, it seems to me that proposals to finance social security entirely from general revenues or from some kind of income tax surcharge which would completely exempt low-wage earners are based on a failure to understand the strengths of the self-help philosophy. If financing were related entirely to ability to pay, it is very likely that benefits, in time, would be related to need. Thus, as a result of a change in financing, we could find that social security had been turned into a welfare program designed to help only the very poor, and that it was no longer a self-help program serving as a base for all Americans to use in building family security.

Moreover, the security of future benefit payments is greatly reinforced by the concept of a dedicated social security tax or contribution paid by the people who benefit under the system. The moral obligation of the government to honor future social security claims is made much stronger by the fact that the covered workers and their families who will benefit from the program made a specific sacrifice in anticipation of social security benefits in that they and their employers contributed to the cost of the social security system, and thus they have built a right to expect a return in the way of social security protection.

Although I believe that this right can be protected even though general revenues share in the cost of the program, it is important to preserve the principle that a significant part of the program be financed by direct deductions from the earnings of all covered workers. The general revenue contribution which might be needed in the next century (or earlier if benefits are substantially improved) can well rest on the rationale of paying for that part of the program which is not directly wage related—the social element in giving a weighted benefit to those with low wages, those with dependents, and those who were no longer young when the program started.

There is a real dilemma, though, as far as the low-wage earner is concerned. He may be getting a "bargain" for his social security contributions—as he is—in terms of long-range retirement, disability, and survivorship protection, but nevertheless questions can be raised about a social policy that forces him to substantially reduce an already low level of current living in order to secure this protection. A possible solution to this dilemma would be to make the refundable earnings credit in the 1974–77 tax bill permanent and to broaden the credit to include low-income workers without children. Under the provision, low-income people get either an income tax credit, or, if they do not have to pay an income tax, they get a positive payment offsetting a considerable part of what they are required to pay for social security. Yet the provision does not change the social security system. It is a subsidy from general revenues to low-income workers.

IS THERE A REMAINING SOCIAL SECURITY FINANCING PROBLEM IN THE NEXT CENTURY?

If the recommended steps are taken, would there still be a deficit in social security financing? The answer is that no one knows, but there is some possi-

bility—even likelihood—that this will be the case. The reason is that we may have an increasing ratio of retired persons to working persons—more taking out of social security as compared to those paying in. This is a situation that, given recent trends, might begin to occur about 2005 or 2010.

While the growth of the population 65 and over since 1900 has been very large and quite steady—rising from 3.1 million in 1900 to 23 million today, an average increase of more than 30% every 10 years—future growth will not be a straight-line projection of the past. After 1980, the rate of increase begins to drop sharply, so that it takes over three decades for another 30 percent increase, with the population over 65 reaching a total of about 32 million people in 2005. Then, as the generation born in the post-war "baby boom" reaches retirement age, the numbers will shoot up from 31 million to 52 million in 25 years. And this is quite certain. This group has already been born, and its size has been estimated on the assumption of relatively modest improvements in mortality rates.

Thus, the problems up to about 2005 are largely unrelated to demographic factors, but after 2005 the key question will be the size of the labor force, the number paying in. On this point there is considerable less certainty than there is about the number over 65, because the number in the labor force depends most importantly on future fertility rates, and the extent to which women, handicapped, and older people work.

Fertility rates have dropped steadily and dramatically since 1957.

In 1957 it was estimated that on the average, women would have 3.69 children. By 1965 the rate was 2.88; by 1970, 2.43; and it is now 1.72. In other words, women are now expected to have only half as many children as they were expected to have in 1957.

Therefore, recent trustees' reports have assumed for the long run that the fertility rate in the United States will not be 2.5 as had been assumed in the 1973 trustees' report, the last to show social security in approximate long-run balance. In the 1977 report, it was assumed rather that the rate would rise slowly and stabilize at 2.1, which is approximately the rate that, over time, in the absence of migration, will produce zero population growth.

The results of changing from a 2.5 fertility rate to an ultimate rate of 2.1 are startling. In 1940 there were 77 million persons in the age group 20–64 and 9 million people over 65, a ratio of 11.7 aged persons for every 100 persons of "normal working age". Comparable figures in 1975 122 million and 23 million, for a ratio of 18.9 aged for every 100 persons of "normal working age". Under the changed assumption there are only minor increases in this ratio between now and 2005, but at that time the growth in the age 20–64 population comes to a halt just at the time the number of people aged 65 and over shoots up from 32 million to 55 million in 25 years, resulting in a ratio of about 34 people past 65 for every 100 persons 20–64. But how certain is the continuation of these low fertility rates for the long run?

If we look not just at the period since 1957, but, say, over the last 75 years, there have been many ups and downs in the fertility rate in the United States. It was high at the turn of the century, dropped sharply at the beginning of the depression of the 1930's, began to rise during World War II, and remained on the rise until 1957. If the fertility rate were to rise quickly to 2.5 again, there would, of course, be no long-range social security financing problem of the type now anticipated.

Population experts have, on the record, not been particularly successful at predicting fertility rates, and in that sense everyone can take his choice on the basis of past experience. Yet it may be imprudent to count on there being a return to the fertility rates of the late 1960's and 1970, and in this way dismiss any long-range social security financing problem. The widespread knowledge about, and availability of, inexpensive methods of contraception, the tendency to prefer a higher level of living made possible by a smaller family, and the widely recognized major social reasons for zero population growth (ZPG), persuade me that it is reasonable to base projections of social secur[illegible] costs on a fertility rate ultimately producing ZPG. If we are going to have such fertility rates, we ought to start thinking about the retirement policy that makes sense under ZPG conditions, because the most significant social trend causing higher than necessary social security costs in the next century is the trend toward earlier retirement.

In the last trustees' report, the trustees have assumed a continuation of this trend and have estimated a further long-range reduction in labor force

participation on the part of people over 60. If we could, instead, have greater labor force participation among older people in the next century than we have today, there could be a significant saving for social security over what is currently estimated.

There may well be a question whether a policy of earlier and earlier retirement makes sense—either for the individual or for society—when one considers the probability of more older people living somewhat longer and with a high proportion of those in the younger part of the aged population being in reasonably good health. One quite possible and highly rational response to the change in the population distribution that will arise under the fertility assumptions leading to ZPG would be for society to employ a higher proportion of people over 60 rather than a lower proportion, as has been assumed in the cost estimates.

The most fundamental determinant of the cost of pensions is the proportion of the aged group that is productively employed. This is true because private plans almost always require retirement from the particular employer or industry as a condition of drawing benefits, and social security reduces benefits in proportion to earnings for those who earn more than relatively low exempt amounts.

I believe if we want to continue retirement plans that replace wages to the extent we have promised, improve health insurance and long-term institutional care for the elderly, and add the services needed to allow older people to be cared for outside of institutions if they prefer, we had better give high priority over the next 30 years—before the crunch comes—to reversing the trend toward earlier and earlier retirement. It is one thing to be able to support good retirement programs and other programs for the elderly under conditions of a rapidly increasing population over 65 if most people work up to 65 or later. It is something else again if people generally stop working at 60 or even younger.

It should be pointed out, on the other hand, that the increasing demand on goods and services by the aged, which would result from these population projections, will be offset by a decline in the number of younger dependents. If we look not just at the aged but at the combined number of people below 20 and over 65, and consider this combined group to be the number to be supported by active workers, we get a very different picture than when looking at the aged alone. Even allowing a higher per person living cost for older people than for children, it can still be said with considerable confidence that the kind of population shift that may occur in the next century does not represent any significant increase in overall economic burden on active workers, but rather an increased obligation to support older people, balanced by a lessening of the obligation to support children (table attached). Moreover, it may be assumed that, with fewer children, a higher proportion of women will work in the future as compared with today, a fact that improves the ratio of workers to retirees.

From the narrow point of view of the closed system of social security, however, there may well be some problem. Since about four-fifths of the cost of the system is for the payment of benefits to older people, the somewhat lower cost to the system of survivors' and dependents' benefits paid to children is offsetting to only a minor degree, and increases in labor force participation by women have already been taken into account by the trustees. Looked at strictly from the standpoint of the social security system in the next century, the issue could well become whether the "savings" from the lessened burden of raising children can be translated into a willinngess to pay higher rates for retirement protection.

CONCLUSION

Now what does this all add up to? I believe the wise policy would be to take action now that would fully support the system over the next 35 years or so. The Administration's plan is the best plan I have seen for accomplishing this purpose. The actions also reduce the long range actuarial imbalance to an estimated 1.9 percent.

To help further reduce this estimated imbalance, I believe we should work toward policies that promote employment opportunities for the handicapped and for older people.

Whether after these actions an imballance would still develop in the next century is uncertain. We will know much more about that 10 or 15 years from now after we have had a chance to observe the developing trend of fertility rates, disability rates, and the other uncertain factors that govern long-range costs. In any event, because of the possibility of some remaining long term deficit, I believe it would serve to underline the government's determination to meet all future social security obligations as they fall due to put back into the Social Security Act, the guarantee that was in the law from 1944 to 1950 as follows: "There is also authorized to be appropriated to the trust fund such additional sums as may be required to finance the benefits and payments provided in this title."

ACTUAL PAST AND PROJECTED FUTURE POPULATION OF THE UNITED STATES BY BROAD AGE GROUPS AND DEPENDENCY RATIO

Year	Population (in thousands) as of July 1				Dependency ratio [1]		
	Under 20	20–64	65 and over	Total	Under 20	65 and over	Total
1930	47,609	68,438	6,634	122,681	69.6	9.7	79.3
1940	45,306	77,344	9,019	131,669	58.5	11.7	70.2
1950	51,295	86,664	12,257	150,216	59.2	14.1	73.3
1960	73,116	98,687	17,146	188,949	74.1	17.4	91.5
1970	80,637	112,500	20,655	213,792	71.7	18.4	90.0
1975	77,913	121,807	23,007	222,727	64.0	18.9	82.9
1980	72,837	132,397	25,394	230,629	55.0	19.2	74.2
1990	70,274	147,985	30,044	248,304	47.5	20.3	67.8
2000	75,005	157,580	32,021	264,607	47.6	20.3	67.9
2010	75,583	166,980	34,898	277,461	45.3	20.9	66.2
2020	77,528	167,654	44,977	290,160	46.3	26.8	73.1
2030	80,353	163,774	55,050	299,177	49.1	33.6	82.7
2040	81,591	168,538	55,259	305,388	48.4	32.8	81.2
2050	84,203	174,079	53,254	311,536	48.4	30.6	79.0

[1] Defined as the total number of persons aged under 20 and/or over 65 per 100 persons aged 20 to 64.

Senator NELSON. Our next witness is Prof. Rita Ricardo Campbell, senior fellow, Hoover Institution on War, Revolution, and Peace, Stanford University, and a former member of the Social Security Advisory Council.

We appreciate your taking the time to come and present your testimony. We are also very appreciative of your patience in waiting to testify.

STATEMENT OF RITA RICARDO CAMPBELL, SENIOR FELLOW, HOOVER INSTITUTION ON WAR, REVOLUTION AND PEACE, STANFORD UNIVERSITY, AND FORMER MEMBER, SOCIAL SECURITY ADVISORY COUNCIL

Dr. CAMPBELL. Thank you. For the record, I would like to be referred to as Rita Ricardo Campbell because my maiden name is Ricardo.

I, like the others present, have a long prepared statement which I would like to submit for the record. I do not want to repeat and I will try to extract, if you will accept for the record the longer statement.

There are several issues that disturb me. One, the financing by decoupling; the second, the longrun demographic assumption being made by the 1977 trustee's report of a return to 2.1 births per woman; and several other matters, actually, some misstatements of fact.

For example, at age 65 males live about 4 years less than do females. It changes. Once you are 65, you catch up a bit.

Senator NELSON. I am relieved to hear that.

Dr. CAMPBELL. I would like to speak first to the financing. That is a major issue, and to the proposed use of the countercyclical transfer of funds from general revenues, amazingly retroactively back to 1975, whenever unemployment exceeds 6 percent.

Now, I may have read the statements wrong. I live in California; I received them 2 days before I left. But on page 4 of Secretary Califano's statement of May 10, 1977, before the House Ways and Means Subcommittee, he says that $117 billion are needed between now and 1982 to maintain OASDI benefits and an actuarialy sound reserve fund. And he then proposes to transfer $34 billion from medicare part A hospitalization trust fund and its future tax returns.

Secretary Califano also states that a $24 billion reduction in needed reserve funds is possible. Because of general revenue funding there are needed only 4 months rather than 6 months. The Secretary also would use $14.1 billion from general revenues but footnoted as "initially going to Hospital Insurance Fund * * * ," (p. 6, May 10, 1977, testimony). I have heard today Professor Cohen and Mr. Ball discuss in great detail, as though $14 billion were the only withdrawal from medicare part A trust funds.

I hope before this session is over someone will explain to me what the difference is among the $34 billion, $14 billion, and $7 billion all from medicare or from "a shift of the medicare tax rate."

When I add all of that up, I come up with $50-odd billion. That amount is not in the medicare, part A, trust fund. I served on the Health Services Industry Committee, phase 2, which was the tightest period of price controls on hospitals and I have very little faith that we are going to keep down those prices and costs. The dollars are not there in that trust fund, nor can they be anticipated to be there.

It look's to me like it is getting the camel's nose under the tent of general revenues. That is one point.

I do not know how long you will stay in session. I would like to make several points.

Senator NELSON. We will stay as long as you have something to present.

Dr. CAMPBELL. Thank you.

The 1977 report on the trust fund actually changed back from the 1976 assumption of 1.9 births (intermediate assumption) to the 2.1 replacement rate. I am taking things out of order in order to speak to those points made by others testifying today.

When I was on the Advisory Council on social security, the future birth rate became one of the issues of great discussion and nonagreement. May I suggest that on whatever Councils you appoint in the future, you put more than one or two token women. The disagreement between myself and the rest of the Council members mainly stemmed on this matter of demographics which accounts for two-thirds of the long run actuarial imbalance.

If you look at the vital statistics of today, there is a decline in large families. That stands out. There are very few large families today, that is more than two children, three children at the most.

The belief is, on the part of those who say we will go back to 2.1 children, ultimate fertility rate, is that the recent and current low rates are postponements of births. Another group of demographers

say that we will never go back because the technological method of birth control has changed so that for the first time in history women are deciding how many children they will have, not the male, and as long as this is true, the birth rate will remain low.

If you look at other countries' data, the more women in the labor force, which data have not been mentioned today, the lower the birth rate. It is the two-couple family where the wife works, which is in the majority. One cannot just subtract out the 43 to 45 percent of families where the wife works and state that in the remaining 57 percent or 55 percent where she does not work, the wife is dependent. In 12 percent of families neither husband nor wife works. There are other families that have other arrangements.

The majority of married women are working. I think that should be taken into consideration when you are discussing what to do in respect to the *Goldfarb* decision, the Supreme Court decision of March 1977 that I predicted.

But to go back to the birthrate, if I may look through my statement here a moment and find where my data are—in 1974 there were 68.4 births in the United States per 1,000 women aged 15 to 44 years.

Senator NELSON. 1974?

Dr. CAMPBELL. Yes, sir, 68.4 births.

In 1960—that is only 14 years earlier—there were 118. That is a big change.

I will give you the citation on this.

[Source: U.S. HEW "Monthly Vital Statistics Report" v. 24 1976 No. 11, February 13, supplement 2, table 5, p. 8.]

Senator NELSON. In 1974 there were 68.4 births? What did you say?

Dr. CAMPBELL. Women ages 15 through 44 68.4 births per 1,000. This is a fertility rate. There are three types of birth rate data.

Senator NELSON. In 1960, what was the figure?

Dr. CAMPBELL. In 1960 118.

The big decline is in the births of children, the third, the fourth, the fifth and the sixth in the family. It is the big family that is decreasing. I see no signs of this changing.

I am on a college campus. I have three daughters, two in college, one a teenager, and my belief is that we are not going to go back to 2.1 births ultimate rate per woman. It went down to 1.7, has risen very slightly to 1.8.

The birth rates now are 15 per 1,000 population. To me, it is inconceivable that the 1977 trustees assumed in their reports 2.1 births per woman when today the fertility rate is about the same as in 1974.

Senator DANFORTH. You think there will be a decline in population?

Dr. CAMPBELL. I think the birth rate will go up slowly to about 1.9 per woman and stabilize. Eventually this would stabilize the population. I would not like to predict too far into the future.

Senator DANFORTH. Per woman 1.9. You are talking about 1.9——

Dr. CAMPBELL. Births, ultimate per woman.

Senator DANFORTH. That is not the replacement rate.

Dr. CAMPBELL. No, sir.

Senator DANFORTH. We will have a lower population?

Dr. CAMPBELL. Yes, sir, eventually; many years hence.

I realize that this is something you cannot predict with surety. Only angels would not fear to tread into these areas of demographic predictions of births and deaths. I do not think that when you change the technological method and change the socioeconomic surroundings, such as that many women are working today, more women work than who do not work, that the historic trend line can be followed. My major proposal which involves these data and which my prepared statement covers includes the last chapter of my book "Social Security: Promise and Reality" which will be out at the end of the month.

Senator NELSON. On the point that more women work than do not work, are you saying that over 50 percent of the women in a specific age group do work?

Dr. CAMPBELL. The latest estimates of the Bureau of Labor Statistics, September 15, 1976, which are projected estimates state that by 1990 there will be in the labor force 75 percent of women ages 20 to 24; 64 percent of women 25 to 34 years; 63 percent of women 35 to 44 years and 60 percent of women 45 to 54 years. In 1975, 64 percent of women 20-24, 55 percent of women 25-34 years, 56 percent of women 35-44 years and 55 percent of women 45 to 54 years were in the labor force. As early as 1968 almost 70 percent of women were entitled for a primary benefit based upon their own earnings. By 1990, which is less than 15 years from now, 80 to 90 percent of women will be entitled to a primary benefit.

After all, to have a primary benefit, all you have to do is prove that you have worked in covered employment for 10 years or 40 quarters over a lifetime. I agree with Wilbur Cohen that all jobs should be covered; we should have universal coverage, everybody covered. Then any jobs a woman holds would count for a benefit.

These labor force data are in point of time. It is well-known today that about 90 percent of women have worked 10 years, 40 quarters, earning $3 a week. However, not all earnings are covered earnings. The requirement of $50 a quarter means about 1 hour a week.

Over a lifetime all women except the disabled, very wealthy, or women who may have had an extraordinary number of children will have worked that amount. If secondary spouse's benefits are phased-out rather than taking the proposal initiated by the Advisory Council in 1975 including the offset that Wilbur Cohen presented, then the March, 1977, Supreme Court decisions would cost less. As long as some are covered and some persons are not covered, some people will obtain undue advantage. If an individual is in Federal employment, or is working for the city of San Jose he would have a private pension or a government pension of a different sort than social security. It is the primary pension and should be offset against any secondary benefit under social security.

I am in full agreement with Wilbur Cohen that the offset is second best to universal coverage. This may not be viable. Then the preferable solution, since you now have men and women entitled to benefits equally, would be, over a 50-year period to phase out secondary benefits. I would give a 10-year notice of phase-out over a 50 year period to older widows and widowers; over a 30 year period, phase-out of the retired spouse benefit.

I would give notice to them. I do not think it is fair in any of these items not to give notice. Individuals need the time to readjust their retirement income plans. The Social Security Administration priced out my proposal of the 30 year phase-out of retired secondary benefit and the savings were almost 0.4 percent of long run payroll.

I think, under the present situation of the equal entitlement rights being enforced in social security by the Supreme Court you might even find savings close to 1 percent. I am not an actuary. Certainly, under these circumstances, savings would be greater.

I would like to talk on decoupling. Bob Ball brought that up in great detail. I have been familiar with the system for a long time and it is true that the decoupling method proposed by both the Ford and the Carter administrations is the same. It was also proposed by the advisory council on social security and it would decouple, by wage-indexing earned wages and also would maintain replacement ratios of benefits to earnings.

The consultant panel that was hired on a contract basis was made up of actuaries and economists, and the chairman was Professor Hsiao. Its proposal printed August 1976 does not exactly do—I do not think—what Bob Ball stated it would do.

What it does is index the earnings to the prices and then after one retires, both of them do the same thing: index the benefits to prices so that benefits keep up with the cost of living. Benefits at the time awarded have not increased, however, with the entire growth in productivity. It is a value judgment, whether you want the older person to share in the growth of the real income as well as just maintaining whatever status he had upon retirement.

This is a very much more complicated issue. I am in complete agreement with the other two individuals who testified this morning. It is important to decouple and to do it as fast as you can because the inflation is being counted double. I know that there is agreement on decoupling, although maybe not in how you do it. Decoupling is far less divisive than the other matters involved and it would save about 4 percent of long run payroll under either method of indexing. The Panel's method would save more.

So that is my first priority, to separate that out and get it through.

Senator NELSON. The way the administration proposes?

Dr. CAMPBELL. I would prefer it the other way. If you had to do it the way the administration recommended, pass it just to get it through. We are getting deeper into the hole today because inflation is being counted double.

Also, deflation; that also would be counted double. If there is added on $30-odd billion of increased labor costs upon employers which is what the proposed separation of the tax rate on employers and employees—this is an unique idea—would do, then you would have a potential, in my mind, of deflation, because no employer pays that out of his profits any longer than he has to. He passes that along.

He fires some people, if he can. If he cannot, he just does not rehire when somebody quits. The next time he comes up for wage bargaining he does not give as high a wage increase as he might without the increased tax. It comes out of wages or employment or, the last resort, he will raise prices but the employer does not pay it.

No economist that I know would argue that, in the long run, the employer has not shifted the payroll tax on to the general public either as a worker or as a consumer and, therefore, I think that would be very deflationary.

Actually, the administration's proposal of May 9 admits this. HEW's News Briefing states that "by postponing any form of increased social security tax until 1979" we "avert the risk of impairing the economic recovery this year and next." (p. 2) And the administration assumes that in 1979 unemployment will only be 6 percent or less.

I would like to speak to the 6 percent trigger point because the picture has changed.

If you look at unemployment data from 1947 on, in the United States——

Senator Nelson. 1947?

Dr. Campbell. 1947, because World War II upsets earlier data; You have the armed forces, demobilization and labor force adjustments.

Since 1947 there are only 2 years in that whole period in which unemployment exceeded 6 percent.

Senator Nelson. From 1947 to?

Dr. Campbell. 1975.

Those two years were 1958 and 1961 and unemployment was at 6.8 and at 6.7 percent, respectively. Those are decidedly lower figures than today's. In 1975, it was 8.5 and 1976, 7.7 percent.

However, in 1958 the real gross national product had fallen slightly. In 1975, the real gross national product had not fallen; although it did not increase by much. In 1976, it did fall.

All the other data that an economist looks at do not point to as high a level of unemployment as we are getting. The big question is why?

Uniquely, we have been in a period of rising employment and rising unemployment. Some people have argued that women entering the labor force has caused a great deal of unemployment. If you look at the data, this is not so.

These women are being hired because the service industries are expanding, and it is in the low-paid service industries where women work.

Then others say, unemployment compensation benefits are a little higher than they used to be, or let us say, their duration is slightly unemployment rates are as high as the 8 percents and 7 percents in a longer. That is true. That does not seem to explain entirely, why period where there is not a substantial fall in economic expansion.

According to a recent article, the high measured rates of unemployment may be explained, in large part, "by a new class of individuals who are either largely unemployable or have no need or desire to work but who, to qualify for various welfare benefits must officially register for work and therefore are not counted in official unemployment statistics."

These benefits include those under the Food Stamp program, Aid to Families with Dependent Children, general State welfare assistance, Railroad Unemployment Insurance, Trade Readjustment Allowance, and other Federal programs.

These carry an explicit work registration requirement as proof of eligibility. I read in the newspaper recently that a congressional committee is considering to make these requirements even stricter.

If this analysis is true, then the 6 percent trigger point is not defensible. Once you select any trigger point, 6 percent or 8 percent or 5 percent, you must continuously defend that trigger point.

Senator NELSON. Who is the author of the article?

Dr. CAMPBELL. The authors are Kenneth Clarkson and R. E. Meiners. It is cited in my prepared statement. It apparently is not published yet. It is called, "Inflated Unemployment Statistics: the effects of welfare work registration requirements" presented at a Public Choice Society meeting in New Orleans, March, 1977.

It looked to me as if it were a well-done study. It concerns me. I think it will concern you.

The problem of the employer paying on a different tax base and thus the employee does not receive higher future benefits has already been discussed this morning. I do not want to go into this, beyond stating that the two-worker family, both husband and wife each earning the maximum base, would pay annually over $3,500 in social security taxes by 1985.

Senator NELSON. Under the administration proposal?

Dr. CAMPBELL. Under the administration proposal.

Senator NELSON. They do not increase the base.

Dr. CAMPBELL. The base would be up to $30,300 by 1985. If I earned $30,300 and my husband earned $30,300, and I use the 11.7-percent rate, one-half of it is 5.85 percent and that is a total of direct taxes of $3,545 for both husband and wife. I use that rate although some pays for hospitalization at 65 years and older, because I cannot choose what I pay. I have to pay the whole rate and my employer also has to pay a matching 5.85 percent. The grand annual total is $7,090.

I would like to select some benefits out of the whole package. I could get a better private annuity, because I am entitled only to one benefit, either a primary or a secondary benefit. As a married, working woman who has been paying in for well over 30 years, this lack of return as compared to the nonworking married woman bothers me.

If you accept the fact as do economists that this is a pass-along tax and the employee pays it, I think that the rationale of the separation of the two rates of tax, employer and employee, was not fully explained by others this morning. An increase in the rate of the employer's tax would not account for a future increase in the benefits. I think that another rationale is the possibility that you might fool the public to believe that they are not really paying it, if the employer pays it. In 1976, 16 percent of all households had incomes—not just earnings, that data are hard to get—of between $15,000 and $20,000, 10 percent between $20,000 and $25,000. So therefore you get the working, middle-income person who has children to raise, who may not have many household durable goods, definitely does not own a home free of mortgage as do many older persons, paying the taxes to support the retired aged person who on the whole, is pictured as poorer than the statistics show that he or she is.

There are some disabled, old people, but Alice Rivlin, Director of the Budget, CBO, has stated that only about 5 percent of the U.S.

population are poor, because our welfare programs are working so well.

The Social Security Act was passed in 1935. Since then, there has been a tremendous growth in welfare programs, and we are paying aged persons a tremendous amount of money taxed out of what is believed to be a shrinking labor force of working younger people.

Supplemental security income that some newspaper columnists seem to think is part of social security but it is not, is a welfare program. SSI pays the aged a considerable amount of money and I have the data in my prepared testimony. I can quote them, if you wish.

Senator NELSON. Go ahead.

Dr. CAMPBELL. In 1975, the Federal Government paid income security benefits of $65 billion in cash, $16 billion in kind, a grand total of $81 billion to the aged. Of these dollars, only $7 billion are clearly, entirely welfare payments. Fifty-two billion dollars are social security payments, but these because of dependency benefits and heavy weights for low average covered earnings encompass welfare-type payments. These are not purely welfare payments. In 1976, SSI Federal and State payments to about 2.2 million persons aged 65 years and over were about $3 billion. Total Federal welfare payments to aged persons were over $8 billion,* and to this amount State payments should be added. My objection to the administration's proposal to make all spouses' benefits depend upon the means test, is then that the social security system, if it is also financed in part from general revenues, becomes a welfare program.

If entitlement to secondary spouse's benefits are going to have to depend on proof of support, that is one-half of one's income, not just earnings, over the 3 years prior to the retirement of the primary worker, that is a means test. I remember being on the Advisory Council when this approach to equalizing dependency benefits of men and women came up. I asked to see the form, which men had to fill out.

After several hours, SSA found the form, and the Council unanimously voted down that particular method of equalizing entitlement rights for men and women for secondary benefits. As I recollect, the reasons were the same as Wilbur Cohen mentioned: that the administrative costs are extraordinarily high. You have to check on people. You have to get accurate income data.

It is well known, and substantiated again in my prepared testimony, that the underreporting of income is very much in evidence when you get something in return for underreporting. Here the return would be very great.

There are statistics developed by the U.S. Government, for whatever they are worth, that check, by using independent sources, on how much people underreport income. If it is income from wages and earnings, it is only 97 percent. If the unemployment benefit depends on it, the underreporting is 63 percent. The precise figures and the source are in my prepared testimony.

This worried me. People are willing to cheat to obtain benefits. I would prefer a phase-out with due notice of all spouses' benefits.

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* Source: U.S. Special Analyses, Budget . . . Fiscal Year, 1977.

That would eventually save the system. I do not think many women would object. They would be treated by the social security system the same as men are. They would get a ten year notice of a change, which is preferable to the Administration's proposal to change entitlement rules without a prior notice that would give time for individuals to adjust.

I would suspect, if the Social Security Administration were asked to check, that today, over 80 percent of women are entitled to a primary benefit. Moreover, since full time working women earn, on the average (median), only 57 percent of the average of the annual income of what a male earns, most of them will get those greatly weighted benefits for low earners over a lifetime. This would also be true for part-time workers and intermittent workers. Women more than men work part time and go in and out of the labor force.

There is a 130 percent weight on the benefit corresponding to the lowest lifetime average earnings.

Since many women go in and out of the labor force to have children, they especially get the benefit of that weight. From many points of view, the United States may not want to have an ultimate birthrate per woman that is much beyond 2.1 children. However, married women who work believe that the tax laws discriminate against them because their income taxes are higher and their social security benefits are lower. Therefore, they may work less and have more children. There is nothing in the administration's proposal that corrects the inequity between the married woman who works and the married woman who does not work.

All it has done is recast the inequity into one between the two-worker family and the one-worker family, because labels by sex were removed by the Supreme Court. If two people earn the same covered income in one family, that is up to the maximum base, up to $16,500 then upon retirement, they receive less than does a one-worker family of identical ages and covered earnings record. Correction of that inequity should be made.

The social security program I believe should be considered within the whole tax system and within the welfare system. This is not a small program. Annually 33 million people receive benefits. Over 100 million people are taxed to pay for these benefits. You cannot continue tinkering with it.

Thank you. I will answer any questions.

Senator NELSON. Senator Danforth?

Senator DANFORTH. In a nutshell, your proposal is what?

Dr. CAMPBELL. Immediate decoupling by whatever method you can get agreement on. Longrun phase-out of secondary spouse's benefits; a 50-year period with 10-year notice for survivors, widows and widowers. A 30-year period in which you can play around with how you exactly would do it for a retired spouse.

What can you do about divorced persons?—the Supreme Court presumably would rule that the divorced male would be entitled on the same basis as the divorced female. There is a 20 years of marriage entitlement rule.

That, in a nutshell, is my proposal.

Plus, and I think this is important, that you have universal coverage because unless you have universal coverage, you play the sys-

tem for what it is worth. Anybody who has a half a brain knows how to do it. You work for $3 every week and every 13 weeks you earn enough for one quarter—$50. I have a daughter who modeled, for example, one day. She would be covered for one quarter, that is if she were old enough.

I also, incidentally think of the complaints of a 16-year-old that she is taxed. These taxes do not count toward her benefits until she is 21. That is a very hard one to enforce.

I was not aware, may I state, until very recently that children who are 16 are supposed to pay social security taxes. I was on the advisory council. I think that the law needs simplifying.

There are 13 looseleaf manuals that stretch across desks of people who work for SSA and these employees use those manuals in order to determine what you are entitled to and what you are not entitled to. It is incomprehensible to the average person.

The average person would appreciate simplicity.

Senator DANFORTH. Thank you.

Senator NELSON. Thank you very much for taking the time to come. We appreciate your testimony.

[The prepared statement of Dr. Campbell follows. Oral testimony continues on p. 156.]

STATEMENT OF RITA RICARDO CAMPBELL, SENIOR FELLOW, HOOVER INSTITUTION, STANFORD UNIVERSITY

SUMMARY

Rather than simplifying the social security system, the Administration's proposal makes it for more complex, introduces a welfare test for entitlement to wives' and widows' benefits, and would pay benefits out of general revenues. If these proposals are accepted, social security will be in almost all respects a welfare system.

To restore the system's financial integrity and the average person's belief in its continued existence should be the major goals of social security reform. Therefore, I am in favor of immediate legislation on some form of "decoupling" which would stop counting the inflation twice in computation of benefits. There is agreement on this and it would reduce the long-run actuarial imbalance by about one-half.

The Administration proposes use, retroactively, of a countercyclical transfer of funds from general revenues to OASDI trust funds, whenever unemployment exceeds 6 percent. It proposes to transfer billions of dollars from the Medicare, Part A, hospitalization trust fund. They state that use of general revenues makes unnecessary a reserve greater than an amount equal to four months of benefits and thus arbitrarily reduce the OASDI trust fund by $24 billion. The heavy use of Medicare, Part A, funds is over-optimistic in view of rapidly rising costs of hospitalization. The reduction of the trust fund to equal only four months of benefits is an interesting new approach to sound accounting practice.

The use of a 6 percent unemployment trigger point is indefensible. Since the new requirement of work registration was introduced in 1971 and 1972 for entitlement to various welfare benefits (such as food stamps and aid to families with dependent children) current unemployment rates are overstated. Once any trigger point—six, eight or five—is set, then there is the task of defending that particular level.

The Administration would tax total payrolls of employers, thus adding substantially to their labor costs, while the employee is taxed on covered earnings up to $30.300 per year by 1985. Thus, for a two-worker family, husband and wife, each earning $30,300 social security taxes would be $3,545 per year. Economists are in agreement that employers do not pay increases in payroll taxes out of profits but rather as fast as possible shift the tax primarily onto their employees either through lower wage rates than otherwise would occur

or by hiring fewer workers and, secondarily, by increasing the prices to the consumer.

The Administration would equalize entitlement to spouses' dependency benefits by imposing on wives and widows the one-half support test which, until the recent Supreme Court decisions, husband and widowers had to meet for entitlement to secondary benefits. This would yield $2.6 billion cumulative 1978–1982. A bigger, more equitable gain would be realized if all government workers were covered:—$8 billion in the first year of enactment. As long as some jobs are covered and others are not, and as long as earnings entitlement is $3 per week, people can play the system for individual gain. This is unfair to future generations: our children and grandchildren.

STATEMENT

Thank you, Mr. Chairman. I appreciate very much the opportunity to be present here today. I am a professional economist, have been a member of the 1974-75 Advisory Council on Social Security and am currently a Senior Fellow at the Hoover Institution, Stanford University.

I am going to summarize my prepared statement which is based on the last chapter of my book, entitled "Social Security: Promise and Reality," that will be published later this month by the Hoover Institution Press, Stanford University. The statement contains my plan for making the social security system financially viable, at the same time simplifying this unduly complex program and giving greater equity to many of the over 100 million persons who annually pay taxes to support social security and anticipate receiving social security benefits. It includes in-depth discussions of "decoupling," tax base and tax rates under social security, general revenue financing, demographic changes and effects, early retirement, secondary spouses benefits, need for coverage of all workers in the United States, and other matters that affect the immediate and long-run financing of social security. I would like to submit this statement for the record.

Because it was written in March of this year, my prepared statement does not speak to President Carter's specific proposals of May 9, 1977. This I would like to do now, and then just briefly outline my own proposal.

Unfortunately, the HEW briefing of May 9, 1977, and Secretary Califano's testimony of May 10 before the House, Ways & Means Subcommittee did not reach me until Wednesday of last week, and I had to spend Thursday and Friday by prior commitment in Los Angeles. However, I have read these two items and believe that they raise very serious questions as to the future direction of the social security system. I wish that I had had more time to study and analyze them before my appearance today.

There seem to be three unique aspects of the Administration's plan. First, I will speak to the proposed use of a countercyclical transfer of funds from general revenues to the OASDI trust funds whenever unemployment exceeds 6 percent. This transfer of funds is to be retroactive from January 1, 1975, so that the short-run immediate deficits of the past two years and the current year, 1977, would be made up. In 1975 and 1976, the OASI trust fund paid out more dollars than the total of dollars from taxes and interest received. The fund's total assets in 1974 were $2.4 billion greater than in 1976, when it was as low as $35 billion or equal to only about six months of total benefits payable. In 1974, the Disability Trust Fund's assets were also greater than in 1976 and they had decreased by about the same amount, $2.5 billion—a relatively greater decline to only $5.7 billion, also equal to about six months of total benefits payable. Without legislative action that trust fund will be exhausted in 1979; the other trust fund's assets by 1983.

The Administration combines these two trust funds and estimates that $117 billion are needed between now and 1982 to maintain OASDI benefits and an "actuarially sound reserve fund." The Administration proposes to transfer $34 billion from the Medicare, Part A, hospitalization trust fund and from its future tax returns.[1] Additionally, it proposes to reduce arbitrarily the already low OASDI trust fund by $24 billion, because it claims that use of general revenues makes unnecessary a reserve greater than an amount equal to four months of benefits. By use of this approach there remains only $59 billion

[1] J. A. Califano, Jr. Statement before the Subcommittee on Social Security, House, Ways & Means, May 10, 1977, p. 4.

additional to raise by 1982. In 1955, the OASI trust fund equalled four times the annual total of benefits paid out, and since then the funds have diminished to only one-half of one year's benefits. This does not mean, however, as the Administration has stated, that this is an acceptable level of reserve. Every Advisory Council has recommended a much higher level and although general revenues may appear to be inexhaustible, a four months reserve implies congressional action effective within a four-months period.

It is proposd to obtain the needed additional short-term funds as follows:

	Billions
From general revenues	$14.1
From the increased base on which the employer tax is imposed	30.4
From the increased base on which the employee tax is imposed	3.5
From a "shift of medicare tax rate"	7.2
From an increase in self-employment tax rate	1.2
From an imposition of a one-half support test for entitlement to all secondary spouse benefits	2.6
Total	59.2

However, the above data of the May 10, 1977, testimony are not clear to me. On page 4 of that testimony a reduction of "$117 billion to $83 billion" is accomplished by "retaining the scheduled 1978 and 1981 Hospital Insurance (HI) tax rate increases and reallocating part of the additional funds into the OASDI program. . . ." Yet, on page six the $14.1 billion are footnoted as "new revenues initially going to hospital insurance (HI) fund but reallocated to cash benefit funds through transfers of the HI tax rate." Additionally, the $7.2 billion are identified as from a "shift of Medicare tax rate." Precisely how these three items differ, that is, the $7.2 billion from the previously mentioned $14.1 billion and the first mentioned $34 billion transfusion from Medicare, is not clear. They total $55.3 billion, apparently all from Medicare, Part A fund, and these then appear to be replaced by general revenues.

Because of the size of the imbalances, the present social security system is clearly ". . . at a crossroads. It must either be restructured to conform to the initial dominance of insurance (individual equity) concept or, on the other hand, be allowed to complete its progression towards a welfare system and be financed out of general revenues." [2]

Since the passage of the Social Security Act over forty years ago, there has been a great expansion in the United States of welfare benefits paid by the federal government to the aged. $65 billion in cash and $16 billion in kind—a grand total of $81 billion in 1975. Because of this growth in welfare programs and the maladministration of these programs, such as of the cash social service grants to the states and the recently exposed provider abuses in the "in-kind" Medicare and Medicaid programs—I select the first option of increasing individual equity and reducing the emphasis on welfare.

General-revenue funding is the accepted method of financing welfare or assistance benefits. Its use here would imply to many individuals that persons should meet a means or needs test in order to receive a social security benefit, and in fact the Administration's proposal would use a means test for entitlement by spouses to secondary benefits. It would be preferable to have the secondary benefits to spouses, but not those to children or to aged parents, phased-out over a long number of years. If welfare for some older persons is needed, benefits under the now established Supplemental Security Income (SSI) program are available. Even if the present system of indexing social security benefits is corrected by "decoupling" so that inflation is counted only once, and if all jobs were covered so that the very heavily weighted benefits (130 percent) go only to those with low lifetime earnings, the anticipated, long-run demographic changes still compel a drastic restructuring either to eliminate gradually some portion of the welfare type benefits, or to enact a very substantial increase in revenues.

To make up deficits even with some limits through general revenues, which after all are revenues derived from some other types of taxes paid by individuals, would tend, I believe, to hide the true costs of the system. Because our

[2] R. R. Campbell, "Social Security: Promise and Reality," Hoover Institution, Stanford, 1977, p. 302.

population is aging, general-revenue funding of so-called earned benefits will absorb funds that under alternative options would be available for only those really in need. Here I would like to quote one paragraph from my forth-coming book.

"Proponents of general revenue funding usually state that they would use only revenues from the progressive income tax, and thus equity would increase. Every group that proposes a program requiring large amounts of federal government money lays claim to the progressive income tax revenues. An examination of the income tax structure indicates that this route has only a very small potential of new funding without so increasing the rate of income taxation on low and especially middle-income persons that they will tend to reduce the labor supply and thus affect negatively the size of the gross national product. This route is the one that Great Britain has been following with such disastrous results in recent years." [3]

There are, of course, other types of taxes that could be earmarked for social security benefits. The inheritance tax yielded $11.4 billion in 1974. A value-added tax would yield sizeable revenues but also high prices to consumers. Use of Medicare, Part A, hospitalization funds, I consider to be a mere subterfuge and, moreover, as a past member of the Health Services Industry Committee of Phase II and an conomist, one of whose specialties is health care, I have little faith that hospital costs can and will be contained in the near future.

The Commerce Department has just announced (June 6, 1977) that the government debt during each of the past two years has increased and by 26 percent in the year 1976. The total net federal debt outstanding as of March 1977 is $668 billion.[4] To use general revenues to correct the imbalance in the social security program will not change these data but merely shift deficits from one place in the budget to another.

To affect the federal debt, more money must be raised by taxes, or spending must be cut or new money as through the Federal Reserve be added to the money supply. The latter creates inflation and will hurt most those persons on fixed incomes. OASDI does not transfer income from rich to poor, but rather from working younger persons, often with low or low-middle incomes and few assets, to non-working old or disabled persons. Some of the nondisabled aged, and most are nondisabled, have income from interest, dividends and rents and the majority of this group have assets in the form of homes free of mortgage and automobiles and other consumer assets free of debt. The social security system is an ineffective instrument, as presently structured, to redistribute income from rich to poor.

The six percent unemployment trigger point also concerns me. Data since World War II and its immediate aftermath show from 1947 until 1975 that in only two years, 1958 and 1961, was unemployment at a higher percentage point than 6 percent of the labor force, and then it was 6.8 percent and 6.7 percent, respectively. Yet, civilian unemployment as a percentage of the labor force was 8.5 percent in 1975 and 7.7 percent in 1976; higher levels than in every preceeding year since 1947, and economic expansion as measured by the gross national product, corrected for price changes, actually occurred in 1976, and the real GNP declined only slightly in 1975.

Uniquely the level of employment as well as of unemployment has been increasing during 1975 and 1976. Past relationships among the level of employment, the rate of civilian unemployment and GNP do not imply unemployment rates as high as they have been in 1975 and 1976, but rather rates closer to 4.5 or 5.0 percent. Some claim that because women are entering the labor force at an extraordinary rate higher unemployment is to be expected. But women are also being employed at very high rates because of their concentration in jobs of the expanding service industries. Another common explanation of today's higher level of unemployment is the easier availability and the higher levels and duration of unemployment compensation benefits.

More recently some economists have linked high unemployment rates to the June 1972 requirement of work registration for AFDC benefits and the 1971 requirement of work registration for entitlement of food stamps. A recent article states that—

". . . the high measured rates of unemployment can be explained in large part by a new class of individuals who are either largely unemployable or

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[3] R. R. Campbell, *ibid.*, p. 303.
[4] Federal Reserve Board, San Francisco Office.

have no need or desire to work, but who, to qualify for various welfare benefits, must officially register for work and therefore are now counted in official unemployment statistics. These benefits include the food stamp program, aid to families with dependent children (AFDC), general state welfare assistance, railroad unemployment insurance, trade readjustment allowance, and other federal programs including general aid to Indians. Each of these programs contains an explicit work registration requirement as a condition of eligibility.[5]

If this analysis is true, use of a six percent trigger point is not defensible. Moreover, once any trigger point—six or eight or five percent—is set, then there is the task of defending that particular level, which has been selected.

Another unique proposal of the Carter Administration is to have the employer pay social security taxes on a much higher base salary than that on which employees pay the tax. The proposal would phase-in by 1981 elimination of *any* ceiling on wages of individual employees on which the employer paid social security taxes. The Administration would add to the wage base on which employees pay OASDI taxes a series of $600 increases above those already scheduled so that the annual base for employees' taxes would rise to $30,300 per year by 1985. A two-worker family (husband and wife) each earning the maximum thus would pay directly $3,545 per year and indirectly an additional $3,545 for a total of $7,090 annual social security taxes. This computation uses the 11.7 percent 1977 tax rate of OASDHI, because individuals cannot elect to pay only a portion of the tax.

The rationale appears to be twofold. By this means it may be possible to amend the Act so that the computation of social security benefits uses only those base earnings on which the employee pays the tax. This would reduce the effect of the entire elimination of any ceiling on earned income when computing future social security benefits of highly paid earners. Currently, whenever the earnings base is increased, the future benefits, which are based on total covered earnings, are also automatically increased. However, this unique distinction would widen the tax inequity between persons with earned incomes and unearned incomes, and also between persons working in covered employment and noncovered employment. As I state elsewhere, compulsory coverage of all jobs without exception is needed if the public is to accept taxes only on earned income to support this program.

Moreover, in respect to employees paying on as high a base as $30,300 by 1985, I believe that the following data are pertinent. In 1976, 16 percent of all households had income (not just earnings) between $15,000 and $20,000, and 10 percent between $20,000 and $25,000. Of all U.S. families in 1974, 28 percent had incomes between $15,000 and $25,000. Therefore, this part of the proposal would decrease the disposable income of middle-income workers who generally spend it, as do most of the aged receiving social security benefits. It would also, however, increase the level of their future OASDI benefits to a much higher level than they otherwise would have been. Thus future generations, more specifically our children and grandchildren, will be taxed substantially more to support these higher benefits.

The other reason for the unique proposal that the employer pay social security taxes on his total payroll may be because the Administration believes that the general public is unaware that payment by employers of higher taxes on payrolls does not for any meaningful period of time come out of profits but rather is paid by lower than usual increases in wages or fringe benefits, greater substitution of capital for labor resulting in lesser employment, higher prices to the consumer, or most likely some combination of the above. The Administration estimates that the proposed increases in tax base would require employers to pay an additional $30.4 billion over the four-year period, 1979–1982, an amount that they will shift on to others. Employees will be taxed an additional $3.5 billion over the same four-year period.

The economic effects of such a high tax is deflationary. That the employer sends the government the check is largely irrelevant because this is merely the mechanism of payment. The employer will shift any payroll tax either onto his employees or would-be employees or shift it forward onto the consumer. The Carter Administration admits the deflationary impact of increases

[5] K. W. Clarkson and R. E. Meiners. "Inflated Unemployment Statistics, the Effects of Welfare Work Registration Requirements," presented at Public Choice Society meeting, New Orleans, March 1977, pp. 6 & 7.

in payroll taxes when it states in support of general revenue fundings that it will "Avert the risk of impairing the economic recovery this year and next, by postponing any form of increased social security tax until 1979."[6] The Administration also assumes that unemployment will be below six percent in 1979 despite anticipation by business of higher payroll taxes during the next few years.

I am in agreement with many others that "decoupling," whether by wage-indexing or price-indexing, should be legislated as soon as possible. The longer the delay, the greater the financial hole we are digging because since the effective date of the 1972 amendments inflation is counted twice in the computation of benefits—and if there were deflation, as there well might be if these payroll taxes were passed, it would be counted twice. Because of the substantial agreement in this specific area, I suggest that steps towards immediate legislation on decoupling be taken rather than waiting for agreement on other, more divisive matters. Both methods of decoupling would tie benefits, once awarded, in identical fashion to the cost-of-living index. Wage-indexing was supported by the 1974-75 Advisory Council and also by the Ford and Carter Administrations, while price-indexing was proposed in August 1976 by a panel of experts: economists and actuaries who had the benefit of earlier analyses and the expertise and time to develop that which I, a past member of the Council, believe to be a more viable system. The main difference between the two is that wage-indexing freezes the current benefit-earnings ratio while price-indexing lets benefit-earnings ratios fall when real wages are increasing and rise when real wages are falling. Either method would eliminate erratic future increases in benefits computed under the present formula. Benefits that exceed recent earnings, as the inflation continues, will induce even larger numbers of workers to retire on an actuarily reduced benefit. This means that the ratio of beneficiaries to workers will increase. My preference for the Panel's method is because replacement ratios have already risen substantially and price-indexing does not assume that whatever replacement ratios exist when decoupling becomes effective are the "correct" ratios irrespective of recent erratic increases. Dr. Hsiao, head of that Panel, is scheduled to testify on June 24, 1977, and he could answer more detailed questions on this matter better than I.

The long-run deficit of OASDI was estimated by the 1976 Trustees Report, intermediate assumptions, at 7.96 percent of taxable payroll; in the 1977 Report, 8.2 percent of taxable payroll. "Decoupling," if enacted soon enough, should about halve these deficits.

Decoupling leaves a long-run deficit of about 4 percent of payroll and a short-run deficit of several billion dollars. One specific proposal, that is not likely to be made by persons who work for the government but which would increase substantially the revenues in the first year, is compulsory coverage of all who work. About 8.8 million workers, or 10 percent of the regular labor force of about 85 million in 1975, remain outside the system. Of these, 6 million are government workers, about 2.5[7] million federal, and 3.5 million state and local. Coverage of federal employees would yield annually, according to an SSA estimate based on 1974 data, $8 billion. No federal government job—from the lowliest clerk through the upper cabinet levels—is covered, and therefore those holding these jobs escape that part of social security taxes used to help the already aged, those with much lower than average monthly lifetime earnings, and surviving children. This exemption of government workers adds to the distrust by the public as to the viability of the system and creates resentment when their social security taxes are increased. The long-run savings of covering federal employees is about ¼ of one percent of payroll.

I agree with the Administration that there are hard choices to be made and acknowledge that predictions over 75 years hence are at best informed guesses or what used to be called a "guess-estimate." The long-run imbalance is largely dependent on the demographic trends in births, deaths, marriages and divorce rates: areas of prediction in which only angels usually dare to tread. Yet it is in these demographic areas and in changes in the labor force where the origins of the long-run imbalance occur. By 2030, if there are no changes in the law, intermediate assumptions yield the estimate that 26

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[6] HEW Press Release, May 9, 1977, p. 2.
[7] Full-time equivalent federal employees were 2.9 million in 1974.

percent of total taxable earnings in covered employment will be needed to pay the benefits. This could be reduced by decoupling, if by the wage-indexing method to 19 percent and if by the price-indexing method to 12.5 percent. The year 2030 is 53 years hence. In 2007, those persons born in 1945, part of the post-war baby boom, will be 62 years old and those working will be smaller in numbers, reflecting the low birth rates of recent years. The serious financial squeeze starts then. The demographic trends, I believe, are generally unfavorable and my book analyzes this in considerable length. During the 1960's and until 1977, the birth rate fell to the lowest levels in U.S. history since the 1930's depression. For the first time the birth rate fell during prosperous years. For the first time women are deciding how many children they will have. Although some slight rise has occurred in recent months, it is my belief that 2.1 births per woman are unlikely. Data on numbers of children per family show that large families are becoming very rare. To what precise degree young women have postponed births is still unknown, but in all countries where the labor force participation by women has increased, birth rates have fallen.

My major proposal to ease the financing is to recognize that there have been major socio-economic changes since 1935, to recognize the extraordinary increase in the number of women who work, and also to recognize the decline in the rate of marriages and of births and the increase in rate of divorces.

The Bureau of Labor statistics estimate (September 15, 1976) that by 1990, 75 percent of women age 20 to 24 will be working; 64 percent of women 25 through 34 years; and 63 percent of women 35 through 44 years. As early as 1968 almost 70 percent of women were entitled to a primary benefit based on their own earnings. By 1990, less than 15 years hence, over 90 percent of women will be entitled to a primary benefit. The data which I have just quoted refer to women working at a point in time, rather than women working during a lifetime. It has been well documented that over 90 percent of women work during their lifetime and if all work was in covered employment, it is inconceivable to me that within the next 30 years there would be more than 10 percent of women who have not worked for at least 10 years, the forty quarters required for entitlement to benefits. As long as the ridiculously low amount of $50 of earnings per quarter counts as coverage, it does not take much ingenuity to meet the earnings quarter requirement without really working. Fifty dollars a quarter is equal to about $3.00 a week or one hour of work a week, at today's wage rates.

I propose that retired spouses' secondary benefits be gradually phased out over a thirty-year period and that surviving spouses' secondary benefits be gradually phased out over a fifty-year period. A longer period is needed for surviving spouses because of the much greater life expectancy of women and also of men, at age 65 today, 17.9 years and 13.7 years, respectively. This latter phase-out has not been actuarially priced out, although I have asked the SSA actuary to do so. The Social Security Advisory Council estimated that the phase-out over a 30-year period of retirement benefits would save the system 0.39 percent of long-run payroll.[8] A phaseout of surviving spouses' benefits would save more because the surviving spouse receives 100 percent of the primary benefit while a retired spouse receives one-half of a primary benefit. It is noted that the initial Social Security Administration's estimate of my proposal would have been much higher today because it would also save costs of secondary benefits payable to male spouses on the same basis as paid to females. The Supreme Court in March 1977 equalized entitlement by sex to dependency benefits. All estimates quoted do not take this additional, sizeable cost into account. These decisions, which I had predicted, make my proposals more feasible. Additionally, my argument for phasing out all dependency spouses' benefits is greatly strengthened by consideration of the impact of the Administration's proposal and Secretary Califano's explanation of how he would implement it as given in testimony, May 10, 1977, before the Subcommittee on Social Security of the House Ways & Means Committee.

The Administration would permit a spouse to collect a secondary benefit only if "he or she earned less than one-half of the couple's total income in the three years prior to the application for benefits." (pp. 10, 11) In effect, the Administration is proposing that the one-half support test previously re-

[8] Quadrennial Advisory Council on Social Security *Reports* . . ., March 1975, p. 146.

quired of male spouses now be extended to female spouses rather than allowing continuation of the current situation where no means test is required for entitlement by either husband or wife. The Advisory Council on Social Security considered the Administration's proposal as one alternative which would equalize by sex entitlement to dependent spouse's benefits and turned it down, as I recall by unanimous vote, because it would involve ". . . the necessity of innumerable detailed investigations of personal circumstances and individual determinations of dependency for both men and women, as would be necessary if women were required to prove dependency as men now do. . . ."[9] In other words, the Council members who looked at the several page report form required until the Supreme Court decisions of March 1977 for male spouses to fill out to prove one-half support from their wives was undesirable for all female spouses also to fill out. The form is in effect a means test. It is clostly to administer fairly a means test of this nature because individuals tend to forget or under-report income, especially when receipt of other income depends on the number of dollars that they report. For example, the Bureau of the Census states in its recent issue of *Consumer Income* (P-60, March 1977) that "under-reporting tends to be more pronounced for income sources that are not derived from earnings, such as social security, public assistance, unemployment compensation, etc. . . . In 1975 income from wages or salary was 97 percent of independently derived administrative sources. By contrast, 1975 income from social security payments to beneficiaries was approximately 91 percent of independently derived estimates; income from aid to families with dependent children . . . about 73 percent . . . and income from unemployment compensation . . . about 63 percent."[10] Obviously, the greater the reward for under-reporting income, the more it is unreported. The reward for under-reporting income in respect to a spouse's secondary social security benefit can be expected to be relatively high.

Moreover, the Administration's proposal apparently is to take effect immediately upon passage and allows no time for those spouses who may be made ineligible to what they have previously been entitled to adjust to the unforeseen reduction in retirement income.

The Administration's proposal leaves in place the existing inequity based on benefits to taxes between working and non-working married women but recasts it into an inequity between one-worker and two-worker married couple families. It still would be true that all two-worker families whose total covered earnings equal the annual tax base or lower, would receive less upon retirement than one-worker families where one person earned in each year an amount identical to the amount by the two-worker family. According to Secretary Califano's estimates, the anticipated savings from this proposal is only $2.6 billion, cumulative 1978 through 1982. These are much smaller savings than the $8 billion in the first year of enactment if federal government workers were covered, and the latter seems to me to be a far more equitable proposal. Moreover, the Administration's proposal would encourage one partner of a marriage to retire three years prior to the planned retirement of the other or alternatively to under-report earnings.

It is true that the Supreme Court decisions of March 1977 permit a male who is not dependent on his wife, to collect a secondary dependency benefit if he has not been working in covered employment. It has been true for many years for a wife who under similar circumstances is not dependent on her husband to collect a secondary benefit as long as she has also not worked in covered employment. The inequity occurs because some jobs are not covered by social security and others are. Therefore, individuals can play the odds so that they can maximize their returns. As long as there is no universal coverage, either one has to have some type of means test as the Administration proposes or this expensive loophole exists. The 1975 Advisory Council recognized this and proposed a minimal means test which would not involve income other than earnings and that proposal was that any pension earned outside of the social security system should be offset against any spouses' secondary benefit to which they may be otherwise entitled.

Rather than simplifying the social security system, the Administration's proposal makes it far more complex, introduces a welfare test for benefits and

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[9] Quadrennial Advisory Council on Social Security *Reports* . . ., March 1975, p. 27.

[10] U.S. Bureau of the Census, *Consumer Income,* Current Population Reports, Series P-60, No. 104, March 1977, p. 4.

proposes to support benefits out of general revenues. If these proposals are accepted, social security will have become in almost all respects a welfare system.

It is also important to recognize that over the past 42 years the United States has already developed a welfare system which, although it is more costly than it should be, partly because of fraud on the part of both providers and consumers, has been successful in greatly reducing the numbers of poor in this country. According to the testimony of Alice Rivlin, Director of the Congressional Budget Office, the number of poor are now only about 5 percent of the total population. To estimate the numbers of poor is tricky, as I am sure you are all well aware, because of the different definitions of who is poor and the different measurements of income. It is clear however, that the number of poor has been declining and that in general the poor are not people who are working but are those among us who unfortunately are ill, disabled or a few who do work and have large numbers of children. This latter group is a declining one. It is true that if all spouse's benefits were phased out, there would be some additional individuals who might be defined as poor, but their numbers should be small as there are few people in today's world of inflation who have not worked or will not have worked by 2007, 30 years from now, at least forty quarters during their lifetime. This statement, of course, would be even more true for 2027.

The total of all contributory and noncontributory federal government programs for income assistance in 1976 amounted to $139.5 billion, or about one-third of the total U.S. budget. Nearly $73 billion of this or about one-half was paid out by the social security system. Social security because of its size has important economic effects on the distribution of income and on labor supply.

However,

"The unwieldy, self-conflicting, and incomprehensible body of regulations of the frequently amended law leads the average person to frustration. The individual finds it difficult to understand either the underlying, hopefully logical concepts or, on the practical side, to estimate what he or her retirement benefit five, ten, or more years hence will be." [11]

To restore the system's financial integrity and the average person's belief in its continued existence should be the major goals of social security reform.

Many people covered by social security today protest that the system is inequitable.

"To continue the past policy of tinkering with diffrent aspects, major and minor, in order to correct one inequity by creating another, all for the sake of political compromise, is no longer acceptable to the younger generations who will be paying the bill." [12]

[Proof copy—Chapter 10—"A Plan for Reform"]

[From forthcoming book, "Social Security: Promise and Reality"]

(By Rita Ricardo Campbell, Senior Fellow, Hoover Institution)

A Plan for Reform

The key problems faced by the social security system have now been discussed. Summarized below are my recommendations on the social security program with regard to: (1) coverage; (2) financing; (3) benefits (balancing social adequacy and individual equity, for both men and women); (4) retirement age and the retirement test; (5) simplification of the system.

Coverage and Entitlement Amount

As soon as possible, all workers should be covered by and required to participate in the social security system.

During 1975, about one hundred million workers had earnings that were taxable and creditable toward benefits. About 10 percent, or 8.8 million, of the regularly employed labor force remained outside the system. For reasons of equity no less than the necessity to alleviate the short-run financing problem, all workers should be covered. In "all workers" I would include ideally government employees at all levels despite the probable legal hurdles.

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[11] R. R. Campbell, *op. cit.*, p. 316.
[12] R. R. Campbell, *op. cit.*, p. 317.

There are many reasons why universal participation is a desirable goal. The 6 million government workers—federal, state and local—who comprise the bulk of workers not now covered are not contributing their fair share to the redistributive, social adequacy aspects of the system. Some 2.8 million federal-level officials and employees in the legislative, judicial, and executive branches, as well as some state and local government employees, do not contribute any part of their primary salary to the system's redistributive aspects. Worse, they are also taking advantage of work in secondary occupations to qualify for social security benefits—frequently, for those monthly *minimum* benefits that are greater than the monthly average earnings taxed. Forty-three percent of the current federal civil service annuitants also draw benefits under social security. About one-third of these "double dippers" receive social security minimum benefits weighted in such a way as to favor low-income earners. The number of persons who will become eligible for such double-employment benefits appears to be increasing. Proposals in Congress to include coverage of federal employees naturally have been opposed by strong federal employee organizations.

In addition to the 3.5 million state and local government workers not participating in the system, increasing numbers of such workers now covered are considering withdrawing from it. They have a triple incentive: reducing the federal taxes paid by employer and employee; restructuring the benefits package to eliminate some social security benefits; and using the money so retained to pay for higher benefits in private pension systems. (It is recognized that securing mandatory coverage of state workers poses constitutional states' rights questions that will be difficult to resolve.)

The revenues actually lost because of the current nonparticipants and the potential loss from the increasing number of social security dropouts impose an unfair additional cost on those who have no choice but to remain covered and pay taxes. Their nonparticipation cerates additional pressure to increase the social security taxes paid by those who remain covered and by future generations of covered employees. Covering all government employees—federal, state, and local—would reduce the short-term cost of the system by 0.70 percent of taxable payroll and the long-term cost by 0.25 percent. Universal coverage would immediately increase OASDI tax revenues by about $8 billion annually.

The nonparticipation of government workers in a government-mandated program is creating more and more dissatisfaction among those participants who have no choice but to participate. Particularly dissatisfied are healthy, younger, unmarried workers in higher-paying occupations who know that they could secure a better annuity under a privately run plan, and who value less than older persons the coverage for permanent disability and anticipated hospitalization benefits when 65 years of age (Part A of Medicare). Also dissatisfied are many working married women and their husbands who believe that the benefits are now being distributed inequitably.

The major argument against inclusion of government workers is that they already have satisfactory pension, disability, and survivor plans. In 1975, federal, state, and local governments paid out $21.6 billion in cash benefits to 3.7 million persons under these plans.[1] Obviously, some way should be found to integrate existing government retirement plans with social security. Almost all employees of large companies also have what they generally believe are satisfactory private pension, disability and survivor plans. Yet they are required to pay social security taxes that in many cases exceed their taxes on income. Under many union-negotiated plans, and increasingly under other private plans, the employer's premium to the private insurance company falls as social security payroll taxes rise. Integration of private plans with social security is already occurring. Other existing government plans need to be integrated with social security so that there is a minimum of "double dipping."

Noncompliance by teen-age employees and their employers and the potential high cost of attempting to enforce such compliance are arguments for not requiring that social security taxes be paid by and for young people under 18 (the legal adult age), especially when they work for small employers.

Earnings before age 21 are not counted in computing benefits. Although a few individuals under 18 in the entertainment world make a great deal of money, they pay the progressive personal income tax on their earnings. Most teen-agers make very little, and the law if enforced would dry up further the

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[1] U.S. Department of Health, Education, and Welfare, Social Security Administration, Research and Statistics Note No. 17, August 20, 1976.

odd jobs that are most open to them. The nuisance to the householder in filling out forms for teen-age baby sitters, snow-shovelers, gardeners, etc., results in noncompliance (often they are unaware of the requirement), and fewer such jobs may become available. Knowledgeable and unknowledgeable teen-agers alike resent what they believe is an unfair tax. Young persons are not likely to place a high value on income that they may receive in their old age. The costs of enforcing compliance are probably too high to warrant continuance of social security tax on the earnings of teen-agers under 18. This would be true both of the administrative costs and of the teen-agers' resentment costs.

There should be an increase in the required entitlement amount of $50 total earnings per quarter, which represents earnings of about $3 per week. The amount of earnings required should have some connection with the level of wages in the 1970s. In 1935, $3 a week might have represented one day's pay; in 1977 it represents one hour's pay. Such an increase could be looked on as alternative or—better—complementary to not imposing the tax on workers under 18. In 1977 the annual tax base was $16,500, or 5½ times the initial base of $3,000. The entitlement amount should become at least $200 a quarter, or four times the initial base; at most, it should be $300 or six times the base. The advantage of this increase is that it would decrease the number of double dippers without hurting the low-income earner. An increase to $300 would require earnings of about $24 a week and one to $200 earnings of about $16 a week. It is not known whether these two measures—increasing the entitlement amount and eliminating the tax on those under 18—would result in an actual dollar gain to the system.

Universal, compulsory coverage would eventually prevent windfall benefits to those whose primary work has been in the past in uncovered employment. It would also increase the overall equity of the system, and help to keep increases in social security taxes lower than they will otherwise be. At the same time, the erosion of popular support for the system might be stemmed by this and the other changes proposed. Admonitions to taxpayers by government officials to "do as I say, not as I do" cannot be said to encourage popular support for any government program!

THE FINANCIAL SOUNDNESS OF THE SYSTEM SHOULD BE RESTORED

By 1977, every recent group studying the current and anticipated levels of OASI revenues, taxes, and interest on trust fund monies, and comparing them with expenditures on administration and benefits, had predicted that, beginning with calendar year 1976, payments would exceed income for both the combined old-age and survivors insurance and the disability insurance systems. Furthermore, the shortage was expected to increase in future years. By 1984, unless legislation was enacted, the OASI trust fund seemed likely to be exhausted.

The "intermediate set of alternative assumptions" in the 1976 trustees' report on the OASI trust fund (see document 5.7) yields estimates of future average annual deficits as follows: 0.82 percent of taxable earnings over the period 1976 to 1981; 1.91 percent over the period 1976 to 2000; 6.85 percent over the period 2001 to 2025; and 15.14 percent over the period 2026 to 2050. Under the same set of assumptions, and without any corrective action, the disability insurance trust fund would be exhausted in 1979 and the assets of the oldage and survivors' insurance trust would be exhausted in 1984. As of early 1976, the latter reserve amounted to 8.5 months of the payout rate.

The reasons for an annual deficit in the old-age and survivors' insurance trust fund have been detailed in previous chapters.[2] The total assets of the OASI trust fund fell by about $2 billion from fiscal year 1975 to the end of fiscal year 1976. The major factors causing the projected gap between outlays and tax income were: (*a*) the inflation-fueled, cost-of-living benefit increases mandated by Congress in 1972; (*b*) the unintended "double counting" of inflation in these benefits, also created by the 1972 amendments; (*c*) the failure to match automatic benefit increases by an increase in the tax rate; and especially (*d*) demographic factors, such as the declining birth rate. The last-mentioned factor deserves further comment. The replacement rate is 16.2

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[2] None of the recent study groups had attempted to predict what additional costs might be imposed on the system by the accelerating withdrawals of state and local government groups. The 1976 trustee's report on the trust funds admitted that they could not take account of this new factor.

births per 1,000. In the first half of 1976, the rate was 14.2 per 1,000. Even if this rate increases slightly as the economy improves, a severe financial strain on the system will occur as the so-called postwar babies retire and receive benefits from taxes paid in the future by the relatively smaller labor force produced by the first generation to use oral contraceptives.

During 1976 the death rate, according to the provisional data, continued to decline. In 1975 the general decline in the crude death rate was 3.3 percent over 1974—for those 65 years and over, 4.4 percent. For diseases of the heart the decline was 5.2 percent. Because heart disease is the leading cause of death in the United States, it accounts for 44 percent of the 1975 drop. It is difficult to predict advances in medical prevention, diagnosis, and treatment of disease, but 1974 is the first year of decline in the crude death rate since 1941, when antibiotics became commonly prescribed. The decline in the 1970s appears due to a combination of factors including declining infant mortality rates, and a reduction of automobile accident deaths generally ascribed to the 55-mile-per-hour speed limit. However, the decline also reflects reduction in deaths at older ages, and this is more unusual. If life expectancy continues to increase, albeit slowly, at older ages, it will place a greater drain on the trust fund than originally anticipated. In 1975 life expectancy for males at age 65 was 13.7 years and for females 17.9 years.[3] In the 1939–41 period the comparable figures were 12.1 years for males and 13.6 for females.[4] These amount to gains in average life expectancy at age 65 of 1.6 years for men and 4.3 years for women.

The disability trust fund was anticipated to be drawn down because of the higher than forecasted number of disability beneficiaries who increased from 2.5 million in 1969 to 4.4 million in 1975. Among the reasons were liberalization of entitlement requirements for younger persons, more liberal interpretation of the eligibility criteria, greater awareness of the program, and fewer persons leaving the rolls as "recovered."

Decoupling

Inadequate financing of pension and survivor benefits, both in the short and long run, could be remedied in many different ways. For the immediate period, the most important action would be to correct the double counting of inflation—for instance, by "decoupling" or by freezing the benefit-earnings ratios at different earning levels as of a given date. This would, of course, also help the long-run deficit as would other approaches to improve the financial status of the funds.

Correction of the double count is the obvious first step. In 1976, there appeared to be general agreement in this matter, as represented by proposed decoupling legislation (for example in H.R. 14480, 94th Congress). The problem, if uncorrected, "threatens the solvency of the social security system."[5] The average long-run, 75-year expenditure for OASI benefits of the current, uncoupled system is 15.42 percent of taxable payrolls. This is the estimate in the 1976 trustees' report; it is based on assumptions of 5¾ percent increase in average earnings, a 4 percent increase in the Consumer Price Index, and an ultimate fertility rate of 1.9 children per women. In the 1976 report, these are the intermediate assumptions.

Because the trustees of the OASI and Disability trust funds are the same, data on the two funds are often integrated. Also, an individual's disability benefit is converted to a retirement benefit at age 65. The long-run, 75-year expenditure of taxable payroll for disability is estimated to be 3.51 percent, which when added to the OASI expenditures totals 18.93 percent average expenditure of taxable payrolls. At the same time, the average tax revenues (over the 75-year period) of OASDI, it is estimated, will be only 10.97 percent, yielding a long-term deficit of about 8 percent for the combined OASDI system. The alternative, "low" set of assumptions in the 1976 trustees' report yields OASDI expenditures of 13.83 percent of taxable payroll, while the alternative "high" set increases this amount to 25.47 percent.[6] Obviously, wide ranges may result and 75-year estimates are at best informed guesses.

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[3] Metropolitan Life Insurance Company, *Statistical Bulletin*, May 1976, p. 4.

[4] U.S. Department of Health, Education, and Welfare, *Trends: Part 1, National Trends, 1966-67* (Washington, D.C.: U.S. Government Printing Office, 1976), p. S-16.

[5] David Mathews, secretary of Health, Education, and Welfare, letter to Nelson Rockefeller, June 17, 1976, p. 3.

[6] U.S. Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, *1976 Annual Report*, mimeographed (Washington, D.C.: U.S. Government Printing Office, 1976), p. 91.

Decoupling could reduce long-range deficit by one-half

The benefits formula should be adjusted so that persons not yet retired are compensated only once for inflation. Persons retiring now are receiving benefits computed to reflect the inflation twice: once, in their inflation-related wage increases; and again, in a cost-of-living factor that increases the initial level of benefits awarded, which, since it is derived from wages, already reflects the inflation. Once they have retired, their benefits continue to increase when the cost-of-living increases.

"Decoupling" as was proposed by the Advisory Council and President Ford in June, 1976, may freeze the current benefit-earnings ratio.[7] Alternatively, decoupling can be so constructed as to yield changing ratios in a predictable manner, as for example, the decreasing replacement ratios of benefits to earnings over the years under the Jones Bill (H.R. 12334, 94th Congress). This latter would have reduced the estimated long-run deficit by more than one-half.

Decoupling assumes that the agreed-on, scheduled benefit-ratios for different annual income levels are what society wants for a long period. The existing system lets replacement ratios fluctuate over a very wide range in accordance with deflation or inflation. An example of the inflationary impact under the present system was given by Commissioner Cardwell, November 5, 1975, when he stated that, under certain assumptions as to prices and wages, "in the year 2010 it will be possible for a low-income worker and his wife, both 65 years of age, to receive about $1.34 in benefits for each dollar of the worker's final earnings."[8] Since future benefits will be paid by taxation on work-income of future generations, the system implies compliance by future generations with a "social contract" that they took no part in formulating.

The Advisory Council's proposal was to index wage rates by changes in the average of wage rates, and all wage rate credits would be so adjusted. This would eliminate differences because of the uneven tim-ing of wage rate increases in different industries and by different companies within the same industry. Replacement ratios of benefits to earnings would remain constant.

After persons have retired, their benefits would be computed on their indexed wages. Once awarded, these benefits would then, as now, increase as the cost-of-living increases during retirement. Thus retirees would be fully protected from any impact of cost-of-living increases, even from price increases that might reflect decreases in natural resources—for instance, because of a decline in the supply of oil from abroad. It could be argued that general-indexed protection against the latter type of price increases is not in the public interest and should be extended only cautiously, if at all, to selected groups.

The Consultant Panel's proposal would use a price-index method of decoupling so that replacement ratios of recent earnings would tend to decline when real earnings increase. Either method would protect against occurrence of unpredictable ratios of benefits to past earnings. The result of double-counting is magnified when double-digit inflation occurs. The panel's method would permit Congress to remain in control of the distribution of future growth in real income. No longer would increases in real national income be automatically used to maintain the now unduly high benefits to earnings-after-taxes ratios already in effect in 1977. Demographic predictions are unreliable. It therefore seems wise to leave some leeway for congressional discretion in future years.

There are other proposals for decoupling that differ in relatively minor ways. The Consultant Panel's method, which I prefer, was discussed in detail in Chapter 5, on financing. To repeat that discussion and to include other alternate methods—a fairly complex matter—would confuse those who may read only this, the concluding chapter, without adding to their understanding of the problem.

Insofar as the growth in real national income exceeds 2 percent per annum, there would still be some leeway under the Advisory Council's proposal *if* its

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[7] For example, the revised benefit structure of the 1975 recommendations of the Advisory Council embodied in the administration's bill is as follows: 91% of the first $175 average indexed monthly earnings (AIME), plus 33% of AIME over $175 through AIME of $1,050, plus 17% of AIME over $1,050. U.S. Department of Health, Education, and Welfare. "Explanation to Congress of the proposed Social Security Benefit Indexing Act." June 17, 1976. Table A, p. 2.

[8] James Cardwell. "Remarks." photocopied, (Statement addressed to American business press, Washington Editorial Conference, November 5, 1975), p. 9.

long-run assumptions were met. I concur with the Consultant Panel's more recent proposal, primarily because no one can predict, with any reasonable hope of accuracy, the relevant variables for many years ahead. Therefore, an uncommitted margin of monies is desirable. The panel's method of decoupling would save more than the council's because slightly less benefits would be awarded in future years under the 1976 trustees' intermediate assumptions. For example, under the same set of assumptions and a somewhat higher tax base (initially $18,900 instead of $16,500 in 1977) there is a 1.3 percent of taxable payroll difference, or about $10 billion less benefits paid under the panel's plan in that year.

Under the council's wage-indexing proposal, the immediate diffusion of the first 2 percent of real growth of national income into maintenance of existing ratios of benefits to average earnings implies that the existing replacement ratios are by some magic precisely the ratios that ought to be sustained, and that maintaining them takes precedence over any other use to which the nation's resources might be applied.

If there were no increase in real wages—and in some future years, as when price increases may exceed wage increases, this appears likely—then under the panel's proposal replacement rates would rise, while under the council's assumptions they would of course be maintained. The panel assumes, and again I agree, that if there were no rise in real income for several years in a row, Congress would legislate changes, and that this would be preferable to a rigid replacement-ratio structure of benefits. The average long-run, 75-year expenditures for OASDI benefits would be only 11 percent of taxable payroll under all of the panel's proposals and 15 percent under President Ford's proposal of June 1976.[9] These yield an actuarial imbalance of -0.7 percent and -3.4 percent, respectively. From this alone, it is obvious that long-run actuarial balance is not unobtainable. It is a political not an economic problem.

The importance of recognizing in each of the succeeding three 25-year periods the different patterns of costs over taxes was made clear by the 1976 Trustees' Report on the funding of OASDI:

"Over the first 25-year period the cost would exceed taxes by an average annual amount equivalent to 1.91 percent of taxable payroll, over the second 25-year period by 6.85 percent, and over the third 25-year period by 15.14 percent. In all cases the underfinancing is more pronounced for the disability insurance program than for the old-age and survivors insurance program when viewed as a proportion of the cost of each program.[10]

PROPOSALS TO INCREASE REVENUES

Other proposals, which alone or in combination would help to raise revenues to equal outgo and thus would decrease the short-run and long-run imbalance, are: (1) to extend coverage to include all workers; (2) to increase the rate of payroll tax; (3) to increase the level of base wages to be taxed; (4) to use general revenues from existing income tax or other taxes, as for example, the value-added tax. Inclusion for income tax purposes of OASI retirement benefits upon receipt would not help the OASI trust fund, but would increase the amount of general revenues and, therefore, is relevant.

Because previous sections have discussed in detail the factors in favor of securing universal coverage of all workers and these discussions include the improvement in funding that would result, no further analysis of this will be presented here.

Increase rate of payroll tax

An obvious and simple solution to the short-term deficit is to increase the rate of payroll taxes as recommended by several groups that have reviewed the deficit problem. In the spring and summer of 1976, apparently because it was an election year, Congress delayed consideration of any solutions and rejected President Ford's plan to raise the rate by three-tenths of one percent on employee and employer. It was estimated that such an increase would cost no worker more than one dollar a week and would raise about $3.5 billion

[9] U.S. Congress, Joint Committee (House Committee on Ways and Means, Senate Committee on Finance), *Report of the Consultant Panel on Social Security to the Congressional Research Service,* 94th Cong., 2d sess., August 1976 (Washington, D.C.: U.S. Government Printing Office, 1976), p. 6.

[10] U.S. Trustees. . . . *1976 Annual Report,* p. 93.

annually. However, if the employer-paid portion was assumed to be ultimately paid by the employee, then the cost to the latter would be about two dollars a week.

TABLE 10.1.—COMPARISON OF EXPENDITURES AND TAXES FOR OLD-AGE, SURVIVORS AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL UNDER ALTERNATIVE II

[In percent]

Item	Average for period		
	Old-age and survivors insurance	Disability insurance	Total
1st 25-yr period (1976–2000):			
Expenditures as percent of taxable payroll	9.79	2.02	11.81
Tax rate in law	8.56	1.34	9.90
Difference	−1.23	−.68	−1.91
2d 25-yr period (2001–25):			
Expenditures as percent of taxable payroll	14.00	3.95	17.95
Tax rate in law	9.52	1.58	11.10
Difference	−4.48	−2.37	−6.85
3d 25-yr period (2026–50):			
Expenditures as percent of taxable payroll	22.47	4.57	27.04
Tax rate in law	10.20	1.70	11.90
Difference	−12.27	−2.87	−15.14
Total 75-yr period (1976–2050):			
Expenditures as percent of taxable payroll	15.42	3.51	18.93
Tax rate in law	9.43	1.54	10.97
Difference	−5.99	−1.97	−7.96

Note: Expenditures and payroll are calculated under the intermediate set of assumptions which incorporates ultimate annual increases of 5¾ percent in average earnings and 4 percent in CPI, an ultimate unemployment rate of 5 percent, and an ultimate fertility rate of 1.9 children per woman. (See the text for further detail). Payroll is adjusted to take into account the lower contirbution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

Source: U.S. Trustees of the Federal Old-Age and Survivors' Insurance and Disability Insurance Trust Funds, Annua Report 1976, mimeographed (Washington, D.C.: U.S. Government Printing Office), p. 95.

President Ford, in repeating his proposal in June 1976, which would have increased the tax rate from 5.85 percent to 6.15 percent, or the combined employer-employee tax rate from 11.7 to 12.3 percent, noted that the anticipated gain in revenues of $3.5 billion annually would virtually eliminate the short-run, yearly deficit of about $4 billion. If his decoupling proposal were also adopted, the tax rate increase would further reduce the 75-year deficit by about an additional 10.7 percent of taxable payroll (including a 0.10 percent increase due to increasing the tax on the self-employed to its original rate), yielding a deficit of 3.32 percent. The Consultant Panel, made up of experts and with no public members or politicians, recommended in August 1976 a combined employer and employee tax rate increase of 0.4 percent. A smaller tax rate increase of 0.1 percent on both employee and employer was discussed in the House Ways and Means Committee during 1976 as a less deflationary alternative to a 0.3 percent increase. The 0.1 percent of tax increase, by itself, is too low to change substantially the inadequate funding status of these programs. Congress appears to agree on no tax rate increase beyond scheduled increases. Although there is apparent agreement that legislation to correct the double count of inflation is needed, no legislation as of March 1977 had been passed.

Practically all economists agree that the final incidence of the payroll tax is on the employee. It is not paid out of profits over any meaningful period of time. That the employer "pays" the matching tax is only the mechanism through which the tax is paid. Those who oppose raising the rate of OASDI taxes argue that the tax considered alone is regressive after the limit of the earnings base is reached, and below that level is proportional to earnings. Although there is substantial but not total agreement that, if the benefits are

considered in conjunction with the tax, the social security system is unevenly progressive up to those income levels of the tax base, use of revenues from the personal income tax, which is progressive, would increase that progressiveness and extend it into higher levels of earned income. Income taxes, unlike social security taxes, are levied on what the Internal Revenue Service calls unearned incomes. Persons who oppose increases in the payroll tax rate usually believe in general-revenue financing; they tend to assume that the only source of these additional monies would be from upper-middle and high-income persons. Some, possibly, believe that a small additional amount could come from inheritance tax revenues. Less than 2 percent of taxable returns have annual adjusted gross taxable income of $50,000 or more, and only 7 percent of all total adjusted gross taxable income is in this category.[11] It is obvious, then, that there are insufficient revenues from this tax source to support an ever-growing level of all the benefits now provided and to pay for many other traditional federal government expenditures.

If general revenues become an accepted means of financing a sizable proportion of OASI benefits, additional forms of taxes yielding large revenues are needed. The value-added tax rather than the personal income tax fits this bill in particular. The pros and cons of using general-revenue financing are discussed below.

Earnings base

Another way to increase revenues would be to increase the amount of covered wages that are taxed at a given rate. The wage base that is taxed and on which future benefits are computed already rises under the 1972 amendments with the increase in covered average wages. In 1974 it was $13,200; in 1975, $14,100; in 1976, $15,300; and in 1977, $16,500. During its December 21, 1974 meeting—the Saturday before Christmas—the Quadrennial Advisory Council, with three members absent, voted 7 to 4 to recommend an increase of the tax and benefit base to an arbitrarily chosen amount of $24,000, beginning in 1976.[12] This proposal was supported by J. Van Gorkom, chairman of the Finance Subcommittee, who estimated that it would "save one-half of one percent of the (long-run) cost."[13]

After considerable discussion, the Social Security Administration's acting actuary, Francisco Bayo, stated that "in 1974, 84 percent of all [covered] workers would have had their earnings totally covered by the [1976 base of $15,300]. If we move to . . . $24,000 it would be about 93 percent."[14] Van Gorkom then stated: "So 9 percent lay between 13.3 and 24 thousand. That would be about 8 million workers." The Department of Commerce data show that between the level of $15,000 to $25,000 annual income of one-earner families there were in 1974, 21 percent of all U.S. families, and from $10,000 to $15,000, 29 percent. For all families, many having more than one worker, the corresponding figures were 28 percent and 24 percent, respectively.[15] Thus the decision of December 21, 1974, was based on at best impressionistic data. On January 19, 1975, the Advisory Council voted, all members present or represented, to withdraw this recommendation, which might have acted to depress employment; in all likelihood, it would have decreased the disposable income of many persons and imposed an unexpected high increase in labor costs on employers, who would have passed it back to their employees as soon as possible.

In the long run, the rigidity of labor supply associated with trade-union seniority rules and firms' nonunion personnel practices might delay the anticipated sizable deflationary impact on the economy. Eventually, however, such high additional and unforeseen labor costs might induce employers to lay off workers and possibly also to increase prices. Employeees would have had less disposable income to spend or save.

Also, to increase revenues in this fashion would create a much higher level of future benefits. Benefits are a function of the level of earnings subject to

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[11] U.S. Internal Revenue Service, *Statistics of Income 1972: Individual Tax Returns*, Public Document No. 79, 1-75 (Washington, D.C.: U.S. Government Printing Office, 1975), p. 6.

[12] During all the meetings one member was consistently absent but was represented by another person from the same organization who was permitted by agreement to vote.

[13] Quadrennial Advisory Council on Social Security, 1974, Transcript (Van Gorkom), p. 65.

[14] Ibid., December 21, 1974, p. 68.

[15] U.S. Bureau of Census, *Consumer Income*, January 1976 (Washington, D.C.: U.S. Government Printing Office, 1976), p. 35.

the payroll tax, and therefore any increase in the base taxed eventually creates higher benefits. That benefit increase would eventually have gone to middle-income workers. Proponents, however, argued that increasing the base rather than the rate would initially redistribute income from middle-income to lower-income persons, as from those covered workers with annual incomes of $15,000 through $24,000 to those below $15,000. They also argued that the tax increase was not a burden on the former but rather forced them to save or buy an annuity that later they would enjoy tax-free. Opponents, as noted above, used the latter part of this statement to argue *against* the proposal: in the *long run* it would tend to favor middle-income, not low-income workers. In the short run, earners below $15,000 would not be receiving the benefits except for the small numbers in this group who would be retiring. Avoidance of permitting a higher tax base to count for a later increase in benefits might be possible, if the employer pays taxes on a higher base than does the employee.

Opponents also argued that the benefits were already heavily weighted to favor low-income persons as compared to middle-income persons and that a $24,000 tax base would place an unfair burden on the latter. Thus it would reduce the disposable income of those younger persons, with families to support, who might as yet have relatively few household assets as compared to a large number of OASI beneficiaries, 62 years and over, many of whom owned homes, household equipment, cars, etc., paid no income or social security taxes, and had no children dependent on them. Some of these latter might additionally have sizable other incomes from rents, interest, and dividends, on which, of course, they would pay income tax but no social security tax.

The major private asset of older persons is their home, often owned free of mortgage. In 1967 (the latest detailed SSA data available), 52 percent of individuals 65 years and older, who were not in institutions, owned their own homes, as did 77 percent of married couples in that age bracket. Moreover, 80 percent of them owned them free of mortgages.[16] It is noted that about 40 percent of single aged persons live with relatives. In 1967, the median value of the aged person's equity in home ownership was $11,000. This value is estimated to have risen by 1973 to $18,000. Few younger workers who pay social security taxes own their own homes; generally, they carry sizable mortgages. Comparison of economic classes solely on the basis of covered earnings, which ignores income outside of earnings, durable household goods, home ownership, and other private assets, may lead to the biased conclusion that earners are necessarily better off than those of retirement age. Assets and income from assets are generally underreported.[17]

Because of the inflation, the social security earnings base is moving up automatically and rapidly. Increasing the earnings base will not in the long run redistribute income from middle-income to lower-income persons. It will, however, redistribute income from younger working to retired, nonworking persons. It appears, therefore, that specific legislation to increase funding should not be focussed on the earnings base of the payroll tax.

General-revenue financing

Because of the growing size of the long-run deficit; because demographic factors outside the government's control affect the total dollars paid out in benefits; and because of the large proportion of welfare-type benefits in the system, some argue that general revenues rather than earmarked payroll taxes should support OASI benefits. This is not a new thought. From time to time, however, it has had substantial support from those who believe that OASI should redistribute income from rich to poor by use of personal income tax funding. General-revenue funding also has the support of economist Milton Friedman, but for the opposite reasons: that only in this way will the rapidly expanding expenditures be contained, and the public will realize that it is not an insurance system.

In the mid-1970s, the rate of increase in real growth of the national product was falling. It was argued that it was unfair to burden future workers with the cost of pension-like benefit payments to today's older workers upon their retirement. If both population and real wages continue to fall, pay-as-you-go funding to support the intergenerational transfer of funds represented by the OASI system would become even more unpopular.

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[16] U.S. Department of Health, Education, and Welfare, *Demographic and Economic Characteristics of the Aged*, Research Report No. 45, SSA 75-11802 (Washington, D.C.: U.S. Government Printing Office, 1975), p. 106.
[17] Ibid., p. 124.

Many persons believe, and for different reasons, that only general revenues, as from the progressive income tax and the value-added tax (as yet unused in the United States), have tax capability to generate revenues sufficient to cover the increasing liabilities of OASI as the ratio of beneficiaries to workers increases. They argue that this type of taxation, unlike the current social security tax system, would not reduce business and work incentives. Social security, in their view, induces early retirement, reduces private savings, and therefore, by causing loss of monies available for private capital formation, depresses the size of gross national product.

With the current rates of U.S. personal income taxes and the current frequency distribution of personal income after deductions, any tax that must yield per se a large amount of new revenue cannot be made more progressive unless one wishes to place a limit on allowable annual income after taxes and that limit be set somewhere in the $20,000 to $30,000 range. At these levels, incentives to work are definitely affected. Alternatively, inflation could be permitted so that more persons have earned incomes in the higher brackets. This would yield higher tax revenues if other economic deterrents, such as a much higher price level, were not concomitantly created. Unfortunately, OASI benefits are tied to the price level. This route, then, is a vicious circle. An across-the-board increase in income tax rates is another alternative supported by economist Joseph Pechman.

General revenues may include other types of taxes—notably, the "value-added" tax which is not used by the United States Government, but is used by many foreign governments. The concept of a value-added tax may be explained as follows. As raw material is processed, semi-finished, and finally converted to an end product for sale, there may be several intermediate points of sale. At each point, the purchaser pays a tax on the "value added" by the previous processor. This acts as a tax on a company's sales minus a credit for the amount of value-added tax paid on the company's purchases. It is estimated that a 1-percent value added tax would raise about $4 to $5 billion. Because of probable exemptions and price increases, however, the amount is difficult to predict.[18]

Other taxes that add to general revenues are inheritance and gift taxes. As inheritance taxes increase, they encourage the wealthy not only to increase their current consumption but to make gifts to their children and others. There is, of course, a tax on gifts above certain amounts. The 1976 changes in the law on gifts and inheritance tax somewhat weakened this incentive. However, the laws still encourage more current consumption by wealthy persons, greater investment in human capital (for instance, through education of their children) and less savings. The latter results in less returns to workers because it reduces capital-goods formation. Thus the returns on capital, which are in smaller supply, would be relatively greater than otherwise.

Inheritance and gift taxes do prevent very high concentrations of wealth from being handed down from one generation to the next. Annual yield from inheritance and gift taxes was only $11.4 billion in 1974. A good case on equity grounds can be made for high inheritance taxes and this usually outweighs any economic arguments against them. Such a verdict rests on a value judgment.

It is also possible to raise general revenues from excise taxes, such as those on tobacco and alcohol. The form of taxation that provides the general revenues determines whether income is redistributed from rich to poor or from smokers to nonsmokers.

Others who oppose general revenue taxes state that the decline in the rate of productivity and real wages is temporary and that sensible steps taken now to control benefits and costs would permit today's accepted intergenerational transfer of income system to continue. They consider general revenue monies unacceptable financing of an "earned-benefit" system—the concept on which OASI was originally promoted—and fear that, over time, use of general revenues would transform the current system into a relief system with means test. Some argue further that general-revenue financing, because of the amount of revenues needed—$63 billion of OASI benefits were paid out in 1976—would be the beginning in the United States of new forms of general taxes as, for example, the "value-added" tax. Once additional revenues are gained, governments usually spend the money.

[18] Dan Throop Smith, et al., *What You Should Know About the Value Added Tax* (Homewood, Ill.: Dow Jones-Irwin, 1973).

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There have been proposals to rebate some part of the OASI taxes paid by low-income workers. Such proposals could be in the form of a negative income tax. Since proposals could be in the form of a negative income tax. Since the income tax acts as a means test, it can be argued that all taxation should be administered by the Internal Revenue Service.

The total of all types of income security benefits (including civil service employees and the means-test program, SSI) paid by the federal government to the aged in 1975 were, in cash, $65 billion, and in kind (Medicare, Medicaid, food stamps, etc.) $16 billion—a grand total of $81 billion.

The present social security system is, because of its financial imbalance, at a crossroads. It must either be restructured to conform to the initial dominance of the insurance (individual equity) concept, or on the other hand, be allowed to complete its progression towards a welfare system and be financed out of general revenues.

Because of the great expansion of welfare benefits and their maladministration—for example cash social service grants to the states[19] and the recently exposed provider abuses in the 'in-kind" Medicare and Medicaid programs—I select the first option. General-revenue funding would admit on the financing side a type of funding that is generally used to finance welfare or assistance benefits. It would therefore imply to many individuals that persons should meet a means or needs test to receive a social security benefit. I prefer that assistance-type benefits be largely removed from the social security system, and that they be funded as are welfare benefits under the now established Supplemental Security Income (or SSI) program. Even if the present system of indexing social security benefits is corrected to count inflation only once and all jobs are covered, the anticipated, long-run demographic changes compel a drastic restructuring to separate out a large portion of the welfare-type benefits, or a substantial increase in payroll taxes, or some other way of finding a new source of monies.

In short, it would be better to return the system to the one originally promised in 1935. This was, in large measure, a system of individual equity in which there was a relationship between the amount of taxes paid by the worker and his or her earned benefit. The government could then make good on those promises rather than dilute the social security benefit structure to cover all types of welfare benefits and, by this, force the use of general-revenue financing. To make up deficits without limit through general revenues, which after all the revenues derived from some other types of taxes paid by individuals, tends, I believe, to hide the true costs of the system. And if this happens, the system will become even more of a political football than it has in the past. Benefits will be increased for whatever groups of persons have the largest number of votes. Because our population is aging, general-revenue funding of so-called earned benefits, when there are likely to be many aged people in need, will absorb funds that, under alternative options could be available for those really in need. Moreover, as the gross national product and employment grow, the long-run funding problem of a payroll-tax-supported program should ease.

Proponents of general-revenue funding usually state that they would use only revenues from the progressive income tax, and thus equity would increase. Every group that proposes a program requiring large amounts of federal government money lays claim to the progressive income tax revenues. An examination of the income structure of the United States and its existing progressive income tax structure indicates that this route has only a very small potential of new funding without so increasing the rate of income taxation on low and especially middle-income persons that they will tend to reduce the labor supply and thus affect negatively the size of the gross national product. This route is the one that Great Britain has been following with such disastrous results in recent years.

There are, of course, other types of taxes that could be earmarked for social security benefits and especially for the Medicare benefits, which are not cash benefits directly paid to the consumer. On January 19, 1975, the day on which the Advisory Council recommended diversion of hospitalization trust fund monies to make up the short-run imbalance of the OASI trust fund, I questioned whether a more relevant tax might be an excise tax on cigarettes. This

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[19] Martha Derthick, *Uncontrollable Spending for Social Service Grants* (Washington, D.C.: Brookings Institution, 1975).

was considered by other council members to be merely an attempt to insert some humor into an otherwise very tense situation. It was not.

Very early the Advisory Council as a whole had decided not to review the Medicare Programs, either Part A or Part B, and delegated to its Subcommittee on Finance the charge to study the status of the trust funds of Medicare as required by law. However, the Subcommittee on Finance's report on the consultants' meeting of September 4, 1974, stated the following:

"With respect to the long-range actuarial deficit in the OASDI trust funds, the consultants had discussed the use of general revenue contributions and a lowering of the HI contribution rate with a concomitant increase in the OASDI rate. None of the consultants had technical or economic grounds for recommending a general revenue contribution, and some were strongly opposed to it. Because of the uncertainly of rising hospital costs it seemed unwise to recommend that the contribution rates for HI be changed."[20]

After that date, and prior to its meeting on Sunday, January 19, 1975, when the vote to use Medicare funds was taken, the council had not discussed Medicare further during its several meetings, which under the "Sunshine Acts" were open to the public. Members of the council of course had breakfast, lunch, and dinner with whom they pleased during the days of the meetings. The lack of in-depth data about the Medicare trust fund among even members of the Subcommittee on Finance was clearly indicated by Henry Smith (Actuary and Chairman of the Board, Equitable Life) of that subcommittee in his one-sentence dissent in the printed reports as follows:

"I do not believe the Council sufficiently investigated the Medicare program and probable costs thereunder to be justified in making the unequivocal statement that Part A is actuarially sound."[21]

During its September 20 and 21, 1974, meetings the council voted on several matters with the understanding that all votes were "tentative" because the costs or savings of each proposal created interrelationships among all the proposals. The council voted not to discuss Medicare because Congress had many bills on different forms of national health insurance before it and abuses under Medicare and Medicaid were being investigated. As a past member of the Health Services Industry Committee I knew that, although Phase II controls had reduced the increase in hospital *charges* to a level somewhat less than one-half of the rate of increase before the freeze, when the freeze on medical charges was lifted, hospital costs, which had been rising faster than their revenues, would act as does the steam in a teakettle filled with boiling water: the whistling spout would blow off its top and hospital charges would increase rapidly to make up recent losses. During that earlier meeting, it became clear to me through questioning that the 1974 trustees of the Medicare trust fund had assumed price controls would continue on hospitals when they made their estimates. Price controls in the health sector were removed in April 1974. At the January 19, 1975 meeting, I reminded my fellow council members of this, but the vote was nine to four in favor of diverting Medicare. Part A, trust fund's monies which were bound to decline.

Taxation of social security benefits upon receipt is supported for reasons of equity. Low-income aged who have a double exemption would be unaffected, while middle- and higher-income aged would pay their share of income taxation. It would be preferable to tax the one-half of the benefits represented by past payment by the employer and on which the employee pays no tax when it is received in the same fashion as private pensions. This would both help younger working people and encourage older persons to postpone retirement. The proposal is prospective and does not apply to persons already receiving benefits.

PROPOSALS TO DECREASE EXPENDITURES

Another group of proposals to bring revenues and benefits into long-term actuarial balance are those that would reduce the future costs. These alone and/or in combination could bring the short-run and long-run financing of social security into balance. Costs can be reduced by: (1) reducing types of benefits (for instance, by phasing out dependency spouse benefits); (2) by

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[20] Quadrennial Advisory Council on Social Security, 1974, *Summary of Proceedings*, September 22, 1974.

[21] U.S. Congress, House, Committee on Ways and Means, *Report of the Quadrennial Advisory Council on Social Security*, 94th Cong., 1st sess., H.D. 94-75, March 10, 1975 (Washington, D.C.: U.S. Government Printing Office, 1975), p. 68, footnote 2.

encouraging persons to retire at later ages or even by eliminating the option, now at age 62, of retirement with a reduced benefit. These measures should increase the size of total payrolls taxed, since they would probably reserve the trend of more persons retiring before age 65.

There have been at least four specific printed proposals made to reduce kinds or levels of benefits. One is my proposal to phase out the spouse's retirement benefit over a 30-year period. This is detailed in my dissenting statements to the reports of the Advisory Council. The proposal was estimated in 1974 to save about 0.4 percent of long-run payrolls.[22] Another proposal, by the Task Force on Women and Social Security, would reduce the spouse's dependent benefit to one-third instead of one-half of the primary benefit. It was criticized by James Cardwell, commissioner of social security, on October 23, 1975, as too costly: 1.9 percent of taxable payroll and $9 billion in the first year. It is costly because, while that specific proposal would reduce the cost of spouses' dependent benefits, it also would simultaneously increase all primary benefits by 12½ percent.

The Consultant Panel would abandon "the present schedule of spouse benefits for future retired workers." Instead, it would average "the earnings of the husband and wife for determining benefits of both one-worker and two-worker families."[23] With the increasing divorce rate, this would create administrative difficulties.

Additionally, President Ford proposed to eliminate monthly secondary benefits to persons aged 18 but under 22 who were in school, and who were either surviving children of deceased, covered workers or dependent "children" of retired covered workers' benefits. The argument for this was that, in a pay-as-you-go system, persons aged 18 to 22 who are working and not in school or college are paying social security taxes that may be used to support others in the same age group who are attending college. The current costs are about $1 billion annually.

Retirement at a later age

The Advisory Council recommended in 1975 that there be a gradual phase-in of an increase from age 65 to 68 for entitlement to OASDI benefits, and an increase from 62 to 65 for entitlement to reduced benefits. However, with unemployment in 1975 at the highest levels—and in 1976 only slightly lower ones—since the depression of the 1930s, while employment was also at its highest levels (about 85 million people), pressure for *earlier* rather than later retirement could build. Both unemployment and employment remain high because in each recent year more women work and are seeking work. Early retirement, that is, before age 65, is increasing. This decreases the potential gross national product, social security tax revenues, and the general tax capacity of the country.

The current financial imbalance of the OASDI program (both the pension and disability trust funds) is a strong economic argument from society's point of view for persons to continue work to 65 and even into their late 60s. Economic incentives should be structured to encourage later retirement by individuals. All the present incentives encourage retirement. Although for each year an individual works in covered employment after 65 his or her OASDI benefit is increased by one percent, the OASDI tax rate paid by the employee over 65 and his employer in 1977 is the same as for any other age group, and thus the amount of taxes paid greatly exceeds this small increment in benefit.

A simple way to create an economic incentive for persons to work beyond 65 would be to eliminate OASDI taxes paid by the employee who is 65 or older while retaining the matching employer-paid tax. The cost of this proposal was estimated to be negative (-0.02 of long-run payroll), if earnings after 65 years were not used to recompute benefits. There would be some loss of revenues from social security taxes not paid by employees over 65. Within the total tax structure, however, there would be a gain from their payment of personal income taxes. The social security system as a whole would enjoy an even larger gain because if persons are working and earning more than the retirement test permits, they will not be drawing social security retirement benefits.

To encourage persons to retire later in life, other financial incentives can be devised. Many early retirees with dependents have net untaxed social secu-

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[22] Ibid., p. 146.
[23] *Report of the Consultant Panel . . .* 1976, p. 5.

rity benefits after retirement that are higher than their net after-tax recent earnings prior to retirement. Some persons are dissatisfied with mandatory retirement at age 65 or earlier, as imposed automatically by many firms. They would prefer greater flexibility in individual work-leisure arrangements. The increase in part-time workers at all ages reflects this. A new life style of combining leisure and work in more individualized ways is developing. For example, many men who retire from full-time work at 55 seek part-time work in occupations new to them. Today, there is one part-time worker for every 5½ full-time workers, while 15 years ago it was one for every 10. Among all the unemployed, 20 percent want only part-time work. Although many persons working part tme are women, an increasing percentage are men. Tax incentives could be structured to give greater flexibility of individual choice and at the same time reduce costs of the social security system.

If benefits were not awarded until age 64 (reduced benefit) and age 67 (full benefit), the impact of the existing retirement test would be greatly lessened. To encourage work beyond these years, the council's proposal to reduce the penalty of loss of $1 in benefits for every $2 earned beyond the limit to $1 for every $3 might be more favorably received than it has been. Also, if the age of entitlement to benefits is increased, then a gradual phase-out of the retirement test could be considered, as the cost of eliminating it would be lessened.

Recent popularized versions of medical literature claim that, on the average persons who continue to work live longer. However, I have not seen definitive, controlled studies of observed differences resulting from different ages of retirement by groups of individuals matched at age 62 or 65 years for health status, socio-economic status, and other independent, meaningful variables. Without these kinds of data, no defensible conclusion can be drawn.

Ireland, in 1975, had reduced its age eligibility requirement from 70 to 68, leaving Israel as the only country to have a 70-year requirement. Sweden recently reduced its entitlement age for government pensions from 70 to 67. The recent, more favorable mortality rates for males in the United States and the continued greater life expectancy of females justify a later age of retirement. The initial selection of 65 for full and of 62 for actuarially reduced retirement ages in the United States were both arbitrary decisions. Ideally, individualized retirement ages may be preferable, but large firms may find this difficult to administer.

Manual and assembly-line workers prefer earlier retirement. It is the professional, some service, and white-collar workers who prefer later retirement. Persons who enjoy their work and who remain healthy generally try to continue in their existing or new jobs. The tax system should be structured to favor this choice, not discourage it. The established retirement age for a now-reduced OASI benefit should be looked at within the newly developed benefit pattern of permanent disability benefits. For these there is at least a separate trust fund (admittedly also short of funds and estimated to be exhausted by 1979). Supplemental Security Income, or welfare benefits (SSI), available since January 1974, are also relevant here. To some degree the increase in persons receiving permanent disability benefits reflects a substitution by older persons of these benefits for earlier-than-usual retirement benefits.

In 1975, 59 percent of all retirement benefit awards to men and 72 percent of all retirement benefits to women were to those below 65 years. The trend to retire early is increasing. About 40 percent of men receiving a reduced benefit work part time or intermittently. Data indicate that availability of social security benefits and private pensions influence the decision to retire early as much if not more than a person's state of health. Consideration should be given to increasing gradually the retirement age (*a*) for full entitlement of benefits, at least for non-industrial workers, and (*b*) for reduced benefits for all workers.

Although those persons who do hard physical labor, work on assembly-line jobs, and perform routine work may have started to work at age 18, others, especially those in the professions, may have begun to work at a later age. The latter, if healthy, usually enjoy their work and may be in their more productive years later in life. If one starts to work at age 18, by age 65 he or she has worked 47 years. Persons who have done graduate work in the professions may begin to work at age 24 years or later and those who do post-graduate work may start to work as late as 26 or 28 years. Thus, at age 65, the latter individual (except for possible part-time or summer employment) may have worked less than 40 years.

One approach might be to admit persons who have worked 40 years (or 45 years) to entitlement to a full benefit at age 65. If they have worked less than that amount, they must be age 68, or alternatively received a reduced benefit.

Consideration should be given to retaining the existing lower ages—65 and 62—for persons in certain hazardous occupations such as mining.

Phase-out of dependency, spouse benefits

In my dissent to the Advisory Council on Social Security, I proposed that the retired spouse's benefit should be phased out over a 30-year period. To this I have now added that a surviving spouse benefit should be phased out over a 50-year period. If this were done, there would be major reductions in the costliness of the recent Supreme Court decision, March 2, 1977, *Goldfarb* v. *Califano*, equalizing entitlement by sex to widows and widowers of covered deceased workers, and of the March 21, 1977, Supreme Court's dismissals of cases resulting in equal entitlement by sex to retirement dependency benefits.

Because the Social Security Act was written initially in 1935, it assumes that married women are generally financially dependent on their husbands. At that time "fewer than 15 percent of married women were in the labor force."[24] The Act, although amended many times, still makes this basic assumption, which no longer is true. Married women who work are discriminated against by the statutory law because their dependents have to prove actual financial dependency, while married men's dependents are *assumed* to be dependent. Recent Supreme Court decisions have ruled in specific cases (*Wiesenfeld* v. *Weinberger*, March 9, 1975, re a surviving male parent, and *Goldfarb* v. *Califano*, March 2, 1977, re a widower) that a difference in treatment of spouses of men and of women is unconstitutional. This interpretation was extended by the Supreme Court, March 21, 1977, to all social security cases involving dependency benefits to retired spouses. The requirement for entitlement for a dependency benefit has to be the same whether it is based on a man's or a woman's earnings record. No ruling re divorced males has been made.

To require wives and widows to prove financial dependency, as husbands and widowers are now required, would emphasize the concept of welfare benefits because then a test of need determines whether a benefit is awarded or not. To eliminate the existing requirement that husbands and widowers prove their financial dependency, as the Supreme Court has ruled, will increase the long-run costs of OASI substantially. The Advisory Council favored elimination of the support test only if, concomitantly, all private pension benefits due to an individual on his or her earnings were automatically offset against any OASI dependency benefits to which the individual might be entitled. Even with this offset, costs would increase, and underreporting of private pensions probably would occur. Moreover, new immediate inequities would exist for those persons who, as does a married woman who works in uncovered employment and whose husband works in covered employment, may plan on both a private pension and the dependency retirement benefit.

Although the Supreme Court rulings in March 1977 eliminated the one-half-support-test requirement for males, Congress can specifically impose this test on both females and males because it would equalize the entitlement rules. This action, however, is very unlikely.

Therefore, I propose that both widows' and widowers' secondary benefits be gradually phased out over a 50-year period, in addition to my 1975 proposal to phase out secondary benefits for retired aged wives and husbands over a 30-year period. The savings of the newer proposal should in the long-run be greater than that gained by phasing out secondary benefits to the aged, retired spouse alone, which was estimated to be about 0.4 percent of long-run payroll.[25] A very rough estimate of 0.6 percent in respect to widows and widowers over the 75-year period of long-run payroll yields a savings from both proposals together of 1.0 percent.

TOTAL POTENTIAL LONG-RUN SAVINGS

Decoupling was estimated by the Social Security Administration in 1975 to save under the Advisory Council's method only 1.1 percent,[26] while in June 1976 the amount saved was expected to average 4 percent of long-run payroll[27]

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[24] Ibid., p. 2.
[25] *Reports of the Quadrennial Advisory Council* . . . 1975, p. 146.

and under the Consultant Panel's about two percent more.[28] Universal coverage will save 0.25 percent of the long-run payroll. Thus a total of 4.25 to 6.25 percent of long-run (75-year) payroll costs could be saved, and additional savings could be found. For example, if benefits to students 18 to 22 years were eliminated and/or retirement benefits were available at only later ages, for example full retirement benefits at age 68 years by 2023, one might find an additional amount up to 1.5 percent of long-run payroll.[29]

However, there are also some equity considerations, especially in respect to two-worker, husband-and-wife, families, that would initially cost money. The council's subcommittee's proposal, while would permit them to combine earnings up to the base, seems to me to be very reasonable in that it would help only the low-income, two-worker families who now receive less upon retirement than the single-worker, usually husband-earner, family and where he, the one worker, earns the same amount. The estimated long-run cost of this modest proposal prospectively was about 0.3 percent of payroll. As spouses' benefits are phased out, so that persons pay and receive as individuals, this cost would not necessarily disappear. In fact, if each individual receives on the basis of a close approximation of an "earned right," costs in this area could rise higher than the total of retirement and survivor benefits paid in 1976. However, they would not be as high as under the Supreme Court decisions of 1977 in future years.

The June 1976, long-run actuarial imbalance of about 8 percent of taxable payroll is undoubtedly considerably higher in 1977 because of the annual increases in benefits as the cost-of-living increases; because total payrolls have not increased as anticipated; and because more benefits will be paid to surviving male parents, widowers, and retired husbands. Primarily, however, the actuarial imbalance will become greater and greater the longer the double count of the inflation continues.

Several combinations of the changes suggested here add up to amounts that are near to an actuarial balance. Such calculations lead to optimism if Congress acts to enact needed reforms. Continuation of the program, supported by the same type of tax that has traditionally supported it, is preferable to adding new types of tax revenues, because the program does not redistribute income to the poor. Moreover, existing welfare programs in the United States, according to testimony of Alice Rivlin, director of the new Congressional Budget Office, have been so successful that only 5 percent of the population have annual cash and noncash incomes below the poverty line, as defined by the U.S. Bureau of the Census.[30] This 5 percent figure is the same as the one predicted by J. Palmer and J. Minarik.[31]

HOW THE PLAN INCREASES INDIVIDUAL EQUITY

It is the welfare aspects of OASDI that create problems of financing and inequity. The phase-out of spouse benefits is supported by the extraordinary increases in the percentage of women in the labor force. In 1976, 60 percent and more of women in all the age groups from 20 through 54 years were in the labor force, with a peak of 75 percent for those 20 to 24 years. If all persons are required to be covered, then it will be a very rare person—disabled, or an exceedingly wealthy person, or a woman with many children—who will not have earned an OASDI primary benefit. The trend of a declining birth rate also substantiates my earlier predictions that increasingly more women will work for pay over a substantial period of their adult life. The ratio of beneficiaries to workers will increase because in the long run fewer persons will be born.

Thus the OASDI system could be gradually transformed to reflect individual equity rather than, increasingly, welfare needs. At the same time, children or minors who are dependents of men and women workers would continue to receive benefits as would the more rare case, aged parents. Nonmarried per-

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[26] Ibid., p. 57.
[27] "Social Security Benefit Indexing Act," White House Fact Sheet, June 17, 1976, p. 5 ("Intermediate" Assumptions).
[28] *Report of the Consultant Panel* . . . 1976, p. 8.
[29] *Reports of the Quadrennial Advisory Council* . . . 1975, p. 63.
[30] *The National Observer*, February 19, 1977, p. 1. "The CBO study found only 4 percent are [poor]."
[31] See their chapter "Income Security Policy," in Henry Owen and Charles Schultze, eds., *Setting National Priorities: The Next Ten Years*, p. 526.

sons or singles would also gain more equity. The new welfare programs, especially Supplemental Security Income, could care for men and women in need.

It is true that even if OASDI has identical provisions for men and women, these provisions will not, because of factors outside of the Social Security Act, result in equal treatment of men and women. The Advisory Council refused to consider the latter types of "inequity," and turned down its subcommittee's recommendations to give more equity to the married woman who works, pays OASDI taxes, and yet may upon retirement or widowhood collect no more than if she had never worked or paid sizable taxes.

The above proposed phase-out of spouses' benefits would eventually eliminate this problem. It would not, however, help the low-paid women worker (the median wages of full-time women workers are still only 57 percent of that of full-time male workers), nor the woman who leaves the labor force two or three times to bear and raise children and, therefore, works intermittently. Even if, when she works, she has very high monthly earnings, these are greatly diluted when her average monthly earnings over a work lifetime are computed. This is because the divisor that is used includes all months since age 21 or later whenever she began work, minus five years. The computed average of lifetime monthly earnings minus five years is the basis of the OASI primary benefit.

Although it can be argued that higher wages may eventually be paid to women, even this would not solve the latter problem. If national population policy is to encourage a declining birth rate, some argue that the matter might well stand where it is. If national policy is to encourage 2.1 ultimate births per woman—and in 1976 we were at 1.7 or well below this replacement rate—consideration should be given to an additional three or five year dropout period for the birth of each of a woman's first two children.

Early congressional action on decoupling can be expected to restore financial confidence. However, the basic demographic problem of an increasing aged population relative to the working population cannot be assumed away. It is important in formulation of future policy to have a more precise understanding of the effect of the current social security program on savings decisions before basic changes are made. Whether to phase in a later retirement age and/or to phase out welfare-type benefits can be analyzed well only if there is better knowledge as to the effect of the program on savings.

SIMPLIFICATION

Among other recommendations of the various official groups have been proposals to simplify the social security program. The Advisory Council recommended that:

"When future changes in the social security program are considered, the effect of these changes from the standpoint of program simplification should be taken into account. Continuing attention should be given to simplifying the program, subject to considerations of equity and cost."[32]

The council amplified the above with:

"The social security law now has so many ramifications and so many complex provisions that few people covered under social security understand the nature and extent of the protection provided. This lack of understanding can frustrate individual efforts to plan retirement and to work toward building additional protection to supplement social security. The complexities of the program have also made its administration increasingly difficult. . . .

"The Council's recommendation that the monthly measure under the retirement test be eliminated would simplify the administration of the retirement test provisions. The method of computing benefits the Council is recommending would, over the long run, be a desirable simplification over the present method. Also, in addressing the issue of equal treatment of men and women under the program, the Council has chosen to recommend that the dependency test be eliminated for eligibility for husband's and widower's benefits instead of recommending the addition of a dependency test for wife's and widow's benefits."[33]

The Supreme Court rulings also selected the latter solution to equalize entitlement to men's and women's benefits.

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[32] *Reports of the Quadrennial Advisory Council* . . . 1976, p. 41.
[33] Ibid., pp. 41, 42.

In 1977, there was a thirteen-volume, loose-leaf claims manual that was used by SSA staff to interpret the Social Security Act and the administrative rulings made under it. Although the Consultant Panel also in general indicated the need for greater simplicity in the system, their recommendations, if taken in entirety, would complicate it. This is primarily because they used a concept of family equity rather than individual equity. In 1975 the marriage rate had declined for the third consecutive year, while divorces numbered twice what they were a decade ago. This was the tenth successive year in which the divorce rate had increased. These data emphasized the need for individual rather than family records of earnings.

In 1977, another new government committee was established to simplify the procedures used by the social security system in handling information and computing benefits, and to ensure that it took every advantage of the new advanced technology. Unfortunately, preceding recommendations of this nature have not worked to decrease the complexity of the system, partly because the formula itself to compute benefits is so complex.

In 1976, a revised and up-dated booklet *A Precise Formula for Primary Insurance Amounts* was printed. This booklet has twenty pages and covers only computation of the "primary benefit"! It does not cover the multiplicity of entitlement rules and other formulae. I have included in the following Appendix a table (Document A.3) that gives the precise formula for computing a primary benefit under the benefit tables, and also the computer program (Document A.4), as of June 1975.[34] Additionally, there are several other tables in this publication, but I think the two included in this book are sufficient to indicate the complexity of the computations involved. How one explains such a complex formula to the average citizen, I do not know. Therefore, one of my major recommendations is that a formula be adopted that is simple enough for the average high school graduate to understand.

In respect to entitlement rules, again simplification would be greatly appreciated. Elimination of all spouse's benefits, as already proposed, would eliminate the complicated definitions of when a divorced person may or may not receive a benefit, but it will do nothing to simplify the complex area of entitlement for children's benefits. The definition of a child who is entitled under the act and under what circumstances he or she might receive a benefit are exceedingly complex. Section 737 of the *Social Security Handbook* (1973) clearly states that a child's insurance benefit will be paid "only on one record. . . ." This would be pertinent for a child whose parents worked in covered employment and who were unfortunately killed simultaneously in an accident.

Section 738 states as follows:

"A child entitled to benefits on one earnings record will automatically be entitled on a second social security record, if: A, the child is eligible for benefits on the second and B. any child eligible for benefits on both records applies for benefits on the second record."[35]

Interpretation of the above depends on knowing that the child under B, section 738, is any child additional to the child mentioned under A, because at no time do the law and its administrative regulations deviate from permitting entitlement to only one benefit, whichever is the larger. In other words, the child under B is probably a sister or brother of the child under A.

The unwielding, self-conflicting, and incomprehensible body of regulations of the frequently amended law leads the average person to frustration. The individual finds it difficult to understand either the underlying, hopefully logical concepts or, on the practical side, to estimate what his or her retirement benefit five, ten, or more years hence will be. When the best advice that experts can give to persons contemplating retirement is for them to ask, at least one or two years ahead of the intended time of retirement, for a computation of their primary benefit so that the bureaucratic and computation snarls will be worked out in time before they retire, one must grant that more simplicity would have great virtue. It seems preferable to eliminate gradually the welfare aspects of social security, and thus simplify its requirements and also reduce the number of persons needed to interpret it. This type of simplification would reduce the program's needs for funds and increase equity.

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[34] U.S. Department of Health, Education, and Welfare, *A Precise Formula for Primary Insurance Amounts*, Staff Paper No. 22, mimeographed (Washington, D.C.: 1975).

[35] U.S. Department of Health, Education, and Welfare, *Social Security Handbook*, fifth edition (Washington, D.C.: U.S. Government Printing Office, 1973), section 738, pp. 140-41.

To continue the past policy of tinkering with different aspects, major and minor, in order to correct one inequity by creating another, all for the sake of political compromise, is no longer acceptable to the younger generations who will be paying the bill.

Senator Nelson. The subcommittee will reconvene on June 23 at 10 a.m. The witnesses for the 23d are the AFL–CIO, the National Federation of Independent Business, and the National Council of Senior Citizens.

[Thereupon, at 12:35 p.m. the hearings in the above-entitled matter were recessed to reconvene at 10 a.m. on Thursday, June 23, 1977.]

SOCIAL SECURITY FINANCING PROPOSALS

THURSDAY, JUNE 23, 1977

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2221, Dirksen Senate Office Building, Hon. Gaylord Nelson presiding.

Present: Senators Long, Nelson, Curtis, and Danforth.

Senator NELSON. Today the Senate Finance Subcommittee on Social Security holds its third day of hearings on proposals to solve the immediate and long-term financing problems of the social security system.

Thus far, the subcommittee has received testimony from the Secretary of Health, Education, and Welfare, Joseph Califano, who testified in support of the administration's social security financing proposals, and also has received testimony from a panel of experts which included a former Secretary of Health, Education, and Welfare and a former Social Security Commissioner. Today the panel will hear testimony from several organizations representing labor, small businesses, and older citizens. These groups have a special knowledge of the social security system, and their testimony will be helpful to the subcommittee's consideration of the social security system's financial problems.

The subcommittee today welcomes Andrew Biemiller, Director of Legislation, AFL–CIO; Mel Glasser, Director, Social Security Department, United Automobile, Aerospace, and Agricultural Implement Workers of America; William Dennis, Research Director, National Federation of Independent Business; and Nelson Cruikshank, President, National Council of Senior Citizens.

Given that we have four witnesses, I would like to have each witness make his main presentation in 20 minutes. That would be 1 hour or 80 minutes, and that would not count time for questions and answers.

Go ahead, Andy.

STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, LEGISLATIVE DEPARTMENT, AFL–CIO; ACCOMPANIED BY BERT SEIDMAN, DIRECTOR, SOCIAL SECURITY DEPARTMENT, AFL–CIO

Mr. BIEMILLER. Mr. Chairman, we appreciate this opportunity to present our views in support of the administration's financing proposals for the social security program. A longer, detailed statement

is appended, as well as other relevant material. I respectfully request they be included in the record of the hearings.

The administration has made a number of specific proposals for resolving both the short- and long-run financing problems of the program. If enacted, they will assure the American people that the social security trust funds will remain financially sound into the next century.

President Carter proposes compensating Social Security Trust Funds for a share of revenues lost during recessions. General revenues would be used to replace payroll taxes lost as a result of that portion of unemployment in excess of 6 percent. This temporary feature will operate through 1982. The next Social Security Advisory Council would review the results and make a recommendation as to whether it should be made permanent.

GENERAL REVENUE FINANCING

General revenues are a funding source utilized by most other countries. Many European countries, in addition to payments from employers and employees, assign general revenues to their social insurance systems. Among the nations of the world, governmental participation in social insurance costs is the general rule and exclusive reliance on payroll taxes, as in the United States, is the exception. Yet none of these countries feels that partial financing from general revenues is inconsistent with social security principles.

General revenue contributions to social security have been long contemplated in the United States. The 1934 Committee on Economic Security, the group which drafted the original Social Security Act, predicted the system would need general revenue financing by 1965. Almost every Social Security Advisory Council since then has recommended some general revenue financing.

In fact, general revenues are already being used to pay for wage credits for military service, hospital insurance benefits for noninsured people, special benefits at age 72 for those not eligible for regular benefits, and half of the cost of part B of medicare. In short, the President is only recommending that the Congress expand on a principle which it has already accepted for certain aspects of social security.

REMOVAL OF THE WAGE-BASE CEILING FOR EMPLOYERS

Currently, both the employer and the employee pay social security tax on a limit of the first $16,500 of the employee's earnings, an amount that automatically increases periodically in accordance with rising wages. The President proposes to eliminate the employer's limit and tax his full payroll. It would be phased in by three steps during 1979–85. The President's program would cost most employers less than they would have to pay under the conventional method of financing which would require a major increase in the tax rate.

Senator NELSON. May I interrupt for a question?

Mr. BIEMILLER. Surely.

Senator NELSON. You say it would cost most employers less. Are you just saying that to be careful, or do you know of examples where it would cost them more?

Mr. BIEMILLER. Unless we pursue the program which the President has outlined, there will have to be an increase in the rate.

Senator NELSON. I understand.

Mr. BIEMILLER. And all you have to do is apply it in terms of the small employer particularly, and you will find that it would cost him undoubtedly more if the rate goes up than it would if you simply put the tax on his payroll.

Senator NELSON. You say that it would cost more for most employers.

Are there examples of any class of employer for which it would not cost more to maintain the conventional financing?

Mr. SEIDMAN. Mr. Chairman, I have not tried to do the computation, but it would seem to me if you had an employer with a very high proportion, an unusually high proportion, of employees over the present limitation on the tax base, over the wage base, in other words, that such an employer might be paying more under the President's proposal than if the rate were raised sufficiently for all employers across the board.

Senator NELSON. For employees and employers.

Mr. SEIDMAN. For employees and employers, to provide sufficient funding.

Senator NELSON. I understand. Go ahead.

Mr. BIEMILLER. The employer portion of the tax is based upon the assumption that the employer has a responsibility for paying not only wages but also a deferred wage to help maintain workers and their families when their working days are ended. An employer's responsibility for the welfare of his employees should be related to his total payroll rather than to just a part of each employee's earnings.

In many countries, the employer either pays social security contributions on the total earnings of his employees or his social security taxes are larger than the employee's taxes.

In addition, the employer tax is a business expense and as such is deductible from the employer's U.S. income taxes. The employer's wage base plays no role in determining the benefit amount as it does for the workers; hence, there is no logic in not applying it to the total payroll.

There is one group of employers—State and local governments—whose possible reaction to this proposal causes us concern. The administration's approach would actually have much less impact on them than the conventional approach in which both tax rates and the wage base would be increased. Unfortunately, some State and local governments, facing budget pressures, too often unwisely view withdrawal from the program as a way to help deal with their fiscal problems.

There is clearly a defect in the law which mandates social security for employers in the private sector and prohibits them from withdrawing while allowing public employers to withdraw. It was never intended that retirement income, survivors benefits, medical care, and disability benefits for millions of Americans could be withdrawn merely to satisfy the interest of employers. When the loss of such programs is threatened for so many, there is clearly a need for

Congress to act to require public employers, whose employees are covered by social security, to maintain that coverage.

INCREASE IN WAGE BASE SUBJECT TO EMPLOYEE TAX

The amount of employee earnings subject to the payroll tax would be raised by $600 in each alternate year beginning in 1979 through 1985. These increases would be in addition to the automatic increases in present law that take place in accordance with the rise in covered wages. The Social Security Administration estimates that the wage base, now $16,500, would be $30,300 in 1985 instead of $27,900.

The President's program is particularly commendable because it achieves its objectives without increasing payroll taxes for most workers—taxes which fall heaviest on low- and moderate-income workers. The increase in the wage base would affect only the highest paid workers, less than 15 percent of the work force. The increases in the wage base are important not only as a means of financing the program but also in reducing the regressive aspects of the tax.

The proposal would increase the benefits of those affected since the additional amounts would raise the average wage on which benefits are based. This results in keeping benefits better related to earnings and reflects the fact that social security as a universal system is important to workers with above-average earnings as well as to those with average or low income.

CORRECTION OF TECHNICAL FLAW IN BENEFIT FORMULA (DECOUPLING)

About half of the long-range financing problem of the social security system results from a technical fault in the method of benefit computation for future—not retired—beneficiaries under the automatic adjustment provisions that were enacted in 1972. This procedure adjusts the social security benefit table in line with increases in cost of living for future retirees whenever present retirees' benefits are automatically increased.

In addition, workers' earnings normally increase during their lives and these higher earnings increase the average wage on which benefits are based. If inflation is high and wage increases barely keep up with price increases, replacement ratios—the ratios of benefits to preretirement wages—will drift upward. If gains in real wages are large, and inflation is moderate, the replacement ratios will drift downward.

The same basic procedure was used when ad hoc benefit increases were made during the years 1954–72. It worked well at that time because economic conditions were more stable. Wage and price increases were moderate with wages rising twice as fast as prices. Only if there is a rather substantial gain in real wages—for example, wages grow about twice as fast as prices—can the system be self-supporting at present tax rates. Based on recent economic conditions and those that appear likely in the long run, the procedure will not work satisfactorily in the future and will cause a serious deficit in longrun social security financing. Under present economic assumptions, the result would be benefits exceeding the highest earnings of some beneficiaries in the next century. Congress clearly would not let this happen. How-

ever, present actuarial estimates assume that the trust funds face a serious and almost unmanageable long-range financial problem arising from the anticipated trends.

What has been called "decoupling" has been proposed by the administration to meet both of these problems—that is, a major part of the possible long-term "decoupling" will stabilize these ratios by providing specific replacement ratios of benefits to preretirement wages for the working population. Instead of the uncertainty that now exists, workers will know what future replacement ratios will be. At the same time, there will be no possibility, as under present law, that the future benefits could exceed preretirement wages. This change would eliminate approximately one-half of the program's long-run deficit.

There are a number of ways to decouple. The President's approach, which has wide consensus support, would stabilize the present wage replacement ratios for the working population on into the future. This is called indexing by average wages. Others would index by prices or by other methods so that ratios in the future would decline. These latter approaches severely discriminate against younger workers who, after having paid higher payroll taxes during their working lives, would receive a much smaller percentage of wages in retirement benefits than do today's retirees. We are strongly opposed to this kind of decoupling.

The AFL–CIO, National Council of Senior Citizens, American Association of Retired Persons, the last Advisory Council on Social Security, as well as the number of other organizations, support the administration's decoupling proposal which insures that the replacement ratios for future retirees will be no lower than for current retirees.

That was also the official position of the Ford administration. It is imperative that Congress pass a decoupling proposal which does not deliberalize the present ratio of benefits to wages.

We don't believe that the Congress would want to depress future retirees' living standards and discriminate against today's younger workers. In our opinion, the social security programs should operate as Congress expected when the automatic adjustment provisions were enacted into law. This means eliminating the overadjustment for inflation that would probably occur under present law and providing replacement ratios that remain constant through time at approximately current levels. We strongly oppose any other kind of decoupling. We also insist that for a transitional period of at least 10 years no beneficiary will suffer a reduction in benefits as a result of decoupling.

OTHER PROPOSALS

In addition to these major proposals, President Carter's program for social security would shift revenues from the Hospital Insurance Trust Fund to the cash benefit trust funds; move forward to 1985 the one-fourth of the present increase in OASHDHI tax currently scheduled to go into effect in 2011 and the remaining three-fourths to 1990; increase the self-employed tax from 7 to 7.5 percent; and change certain technical provisions of the Social Security Act which differentiate on the basis of sex.

We support all of these proposals which will help strengthen the financing of the program to the benefit of millions of social security beneficiaries.

Taken together, the President's proposals will reduce the deficit projected by the trustees' report from 8.2 percent of payroll to manageable 1.9 percent average deficit over 75 years. In our opinion, this deficit is unlikely to actually occur because we do not believe the unduly pessimistic assumptions of the trustees' report will be borne out.

The reliability of any long range actuarial assumption diminishes as the length of the projection period increases. There are enormous problems involved in making realistic economic projections for 75, 50, or even 25 years. In the last few years, long term economic assumptions used in the trustees' report have been influenced significantly perhaps unduly, by recent, hopefully transient, economic problems.

The most sensible course at this time is for the Congress to enact the changes recommended by the administration which will assure the financial soundness of the social security system into the next century. Congress should not try to totally solve the small long-range financing problem that remains but should wait a little longer until we are able to judge the most important long-run variables with a greater degree of certainty.

We hope our statement on financing the social security program has been helpful. President Carter's recommendations would, if enacted, put the social security system on a sound financial basis now and into the next century. We are certain that American workers can have every confidence that this subcommittee and the Congress will not only act quickly and favorably on the President's proposals but will continue to improve the program.

Senator NELSON. I take it from your statement that the AFL–CIO specifically endorses each and every provision in the President's proposal?

Mr. BIEMILLER. Right.

Senator NELSON. May I ask one question?

On page 5 you state, "We insist that for a transitional period of at least 10 years no beneficiary will suffer a reduction in benefits."

When you say beneficiary, are you talking about an individual who has retired and is receiving social security income?

Mr. SEIDMAN. We are also talking about those who would be retiring during that 10-year period should be held harmless, in the sense that they would get whichever of these two would produce the higher benefit.

But as I understand it, the administration proposes the same thing for a 5-year period. We are suggesting that a 5-year period might not be adequate.

Senator NELSON. Let's see. The law was changed in 1972, so maybe you have done some calculating. I assume that the inflation has had a multiplier effect each year.

Am I correct in that?

Mr. SEIDMAN. Yes.

Senator NELSON. In other words, someone who retired in 1973 did not receive as much benefit from this change in the law as someone who retired this year.

Mr. SEIDMAN. That is correct.

Senator NELSON. Basically, without having the figures in front of me, we are talking about maybe some significant effect from the 1972 Act, starting around 1974, 1975.

Where would you say?

Mr. SEIDMAN. I don't know exactly, but I would say it would have taken 2 or 3 years for it to have a significant effect.

Senator NELSON. Well, if it were 2 or 3 years, let us assume it was 2, then you were talking about the years 1975–76, and 6 months into 1977, 2½ years.

I am just curious to find out what justification there is for continuing that benefit for someone who has not yet retired.

Mr. SEIDMAN. It seems to us that people who were in the later stages of their working lives had been making their calculations on the basis of the benefits they expected to be able to receive. We are talking about a relatively shortrun period. We are talking about people who are already 50, 52, and beginning to think seriously about their retirement. And we think that those people ought not to be harmed by any change which is made now.

Senator NELSON. When does that 10-year period start? Do you mean starting as of enactment and signing by the President, say, October 1, assuming it's sometime this year?

Do you mean the 10-year period starts then and applies to everyone who retires, each individual who retires October 1 and for the next 10 years thereafter?

Is that what you are saying?

Mr. SEIDMAN. That is what we have in mind because we think those people have already been making their retirement decisions based upon that assumption, including the possibility as to the kind of private pensions that have been negotiated and so forth.

Senator NELSON. So on this one point you do disagree with the recommendation of the President?

Mr. SEIDMAN. Only to the extent that the administration accepts the principle, and we are suggesting the principle ought to be extended in practice further than they suggested.

Senator NELSON. Do you have a cost figure on that?

Mr. SEIDMAN. I do not. We have no independent way of developing cost figures. We could try to obtain a cost figure from the Social Security Administration.

Senator NELSON. We could do that ourselves, but thank you for the offer.

Senator, do you have any questions?

Senator DANFORTH. No; I do not, Mr. Chairman. I am sorry, I came in late.

Senator NELSON. Thank you very much, gentlemen. We appreciate your taking the time to be here today.

[The prepared statement of Mr. Biemiller follows. Oral testimony continues on p. 172.]

PREPARED STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR & CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. Chairman, on behalf of the AFL-CIO, I wish to thank you for the opportunity to present our views with respect to the Administration's financing proposals for the Old-Age, Survivors, Disability and Health Insurance Program

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(OASDHI). Additional material outlining AFL–CIO Social Security policy is attached and I respectfully request that this material be included in the record of the hearings.

The financial stability of the Social Security program is of deep concern to the AFL-CIO. American workers contribute nearly half of the money that goes to the trust funds. Workers and their families are by far the largest group of beneficiaries. Whether the trust funds will have sufficient monies to pay the benefits workers have earned is of the greatest concern to us. But we do not accept unfounded allegations that the system is bankrupt now or will be in the future.

The fact that contribution income is less than outgo for benefit payments for a year or two should not be a cause of major concern. The major reason Social Security trust funds exist is so that they can be drawn upon during such contingencies. In addition, the fact that beneficiaries are receiving more money to spend than is taken in payroll taxes has had a positive effect in stimulating a depressed economy. However, this deficit cannot continue indefinitely and action must be taken to insure the future financial stability of the OASDI trust funds. This should be done as soon as possible in order to maintain public confidence in the system and to bring peace of mind to millions of our retired citizens.

The short-run deficit has resulted from two major causes. First, a much greater than projected inflation rate has triggered higher cost of living benefit increases relative to income from increasing wages. Second, a much higher than expected unemployment rate has curtailed expected revenues. In short, benefit costs are more and estimated revenues are less than had been anticipated.

The long-run problem which will develop largely in the 21st Century, arises primarily from two causes. The first from the assumption of the most recent trustees' report that the fertility rates of recent years—the number of children women are expected to have—will stabilize at a rate that will eventually produce zero population growth. If correct, this means that starting about 30 to 35 years from now, there will begin to be a sizable increase in the number of retired persons relative to active workers. In short, fewer people at work will have to support more retired people than previously estimated. However, the effect of this will be somewhat mitigated because they will also have fewer children to support.

The record results from an unintended, but easily correctable, error in the benefit formula included in the automatic adjustment provisions of the 1972 amendments. This formula under present assumptions overcompensates for inflation.

The Administration has made a number of specific proposals for resolving both the short and long run financing problems of the program. If they are enacted, they will assure the American people that the Social Security trust funds will remain financially sound into the next century.

GENERAL REVENUE FINANCING

President Carter proposes compensating Social Security trust funds for a share of revenues lost during severe recessions. General revenues would be used to replace payroll taxes lost as a result of the portion of unemployment in excess of six percent. This temporary feature will operate through 1982. The next Social Security Advisory Council will be asked to review this proposal and to make a recommendation as to whether it should be made permanent.

The United States is one of the few advanced industrial nations in the world in which the Social Security System is financed entirely from payroll taxes. There has been support for a government contribution from general revenues from the inception of the program. Organized labor supported the payroll tax at the time the Social Security program began despite its burden upon low income workers. However, organized labor and many other supporters of this legislation viewed exclusive reliance on the payroll tax as a transitional stage.

Mr. Chairman, if you will examine the record of the past you will find that in these early years the Social Security Board, Advisory Councils, Congressional spokesmen and organized labor, as well as other groups and knowledgeable individuals, including business and industrial leaders, asserted the need

for a general revenue contribution at some appropriate stage in the development of the system. Organized labor believed, as did many others, that exclusive reliance on the payroll tax was necessary during the initial phase of the program in exchange for the benefits of the new protection. But, at the same time, we felt that ultimately action would be taken to limit the burden upon low and middle income workers.

In fact, the original Social Security legislation submitted to Congress in 1935 recommended a government contribution to cover past service credits and even mentioned 1965 as the most likely year when such contributions would be required. Provisions for a government contribution were actually included in the Social Security Act from 1944 to 1950 and, though removed in the amendments of 1950, its removal was against the recommendation of the Advisory Council on Social Security.

In addition, government contributions are already being used to meet a minor but nevertheless a significant portion of the program costs—wage credits for military service, hospital insurance for the non-insured, matching funds for the Part B premium, and for the age 72 special benefits. In short, Mr. Chairman, this is not a new proposal but an old one that now needs to be more fully implemented.

REMOVE THE WAGE-BASE CEILING FOR EMPLOYERS

Currently, both the employer and the employee pay Social Security tax on a limit of the first $16,500 of the employee's earnings, an amount that automatically increases periodically in accordance with rising wages. The President proposes to eliminate the employer's limit and tax his full payroll. It would be phased in by three steps during 1979-1985. The President's program would cost most employers less than they would have to pay under the conventional method of financing which would require an increase in both the tax rate and wage base.

The employer portion of the tax is based on the assumption that the employer has a responsibility for paying not only wages but also a deferred wage to help maintain workers and their families when their working days are ended. An employer's responsibility for the welfare of his employees should be related to his total payroll rather than to just a part of each employee's earnings.

In many countries, the employer either pays Social Security contributions on the total earnings of his employees or his Social Security taxes are larger than the employee's taxes. In the U.S., the employer tax is a business expense and as such is deductible from the employer's income tax. The employer's wage base plays no role in determining the benefit amount as it does for the workers. There is no logic in not applying it to the total payroll.

There is one group of employers—state and local governments—whose possible reaction to this proposal causes us concern. The Administration's approach would actually have much less impact on them than the conventional approach in which both tax rates and the wage base would be increased. Unfortunately, some state and local governments, facing budget pressures, too often unwisely view withdrawal from the program as a way to help deal with their fiscal problems.

There is clearly a defect in the law which mandates Social Security for employers in the private sector and prohibits them from withdrawing while allowing public employers to withdraw. It was never intended that retirement income, survivor benefits, medical care and disability benefits for millions of Americans could be withdrawn merely to satisfy the interest of employers. When the loss of such programs is threatened for so many, there is clearly a need for Congress to act to require public employers, whose employees are covered by Social Security, to maintain that coverage.

INCREASE IN THE WAGE BASE SUBJECT TO THE EMPLOYEE TAX

The amount of employee earnings subject to the payroll tax would be raised by $600 in each alternate year through 1985 beginning in 1979. These increases would be in addition to the automatic increases in present law that take place in accordance with the rise in covered wages. The Social Security Administration estimates that the wage base, now $16,500, would be $30,300 in 1985 instead of $27,900.

The President's program is particularly commendable because it achieves its objectives without increasing taxes for most workers—taxes which fall heaviest on low and moderate income workers. The increases in the wage base would affect only the highest paid workers, less than 15 percent of the workforce. The increase in the wage base is not only important as a means of financing the program but also in reducing the regressivity of the tax.

The proposal would increase the benefits of those affected since the additional amounts would raise the average wage on which benefits are based. This results in keeping benefits better related to higher earnings and reflects the fact that the Social Security system is important to workers with above-average earnings as well as to those with average or low income.

The program now covers about 85 percent of the full wages of workers. This compares with 97 percent when the program began. The same proportion of workers should have their full wages covered as when the Social Security law was first enacted. The President's proposal is a major advance toward that objective.

CORRECTION OF TECHNICAL FLAW IN BENEFIT (DECOUPLING)

About half of the long-range financing problem of the Social Security system results from a technical fault in the method of benefit computation for future (not retired) beneficiaries under the automatic adjustment provisions that were enacted in 1972. This procedure adjusts the Social Security benefit table in line with increases in the cost of living for future retirees whenever present retirees' benefits are automatically increased. In addition, workers' earnings normally increase during their working lives and these higher earnings increase the average wage on which benefits are based. If inflation is high and wage increases barely keep up with price increases, replacement ratios (the ratio of benefits to pre-retirement wages) will drift upward. If gains in real wages are large and inflation is moderate, the replacement ratios will drift downward.

The same basic procedure was used when ad hoc benefit increases were made during the years 1954-72. It worked well at that time because economic conditions were more stable. Wage and price increases were moderate with wages rising twice as fast as prices. Only if there is a rather substantial gain in real wages (i.e., wages grow about twice as fast as prices) can the system be self-supporting at present tax rates. Based on recent economic conditions and those that appear likely in the long run, the procedure will not work satisfactorily in the future and will cause a serious deficit in long-run Social Security financing. Under present economic assumptions, the result would be benefits exceeding the highest earnings of some beneficiaries in the next century. Congress clearly would not let this happen. However, present actuarial estimates assume that the trust funds face a serious and almost unmanageable long-range financial problem arising from the anticipated trends.

What has been called "decoupling" has been proposed by the Administration to meet both of these problems, i.e., a major part of the possible long-term fiscal problem and a stable ratio of benefits to pre-retirement wages. "Decoupling" will stabilize these ratios by providing specific replacement ratios of benefits to pre-retirement wages for the working population. Instead of the uncertainty that now exists, workers will know what future replacement ratios will be. At the same time, there will be no possibility, as under present law, that in the future, benefits could exceed pre-retirement wages. This change would eliminate approximately one-half of the program's long-run deficit.

There are a number of ways to "decouple." The President's approach, which has wide consensus support, would stabilize the present wage replacement ratios for the working population on into the future. This is called indexing by average wages. Others would index by prices or by other methods so that ratios in the future would decline. These latter approaches severely discriminate against younger workers who, after having paid higher payroll taxes during their working lives, would receive a much smaller percentage of wages in retirement benefits than do today's retirees. We are strongly opposed to this kind of "decoupling."

The AFL-CIO, National Council of Senior Citizens, American Association of Retired Persons, the last Advisory Council on Social Security, as well as a number of other organizations support the Administration's "decoupling" proposal which insures that the replacement ratios for future retirees will

be no lower than for current retirees. That was also the official position of the Ford Administration. It is imperative that Congress pass a decoupling proposal which does not deliberalize the present ratio of benefits to wages.

However, we strongly disagree with what we understand the Administration will propose as a transitional provision in relation to "decoupling." The purpose of such a provision is to guarantee future beneficiaries for a period of time that their benefits under the new "decoupling" formula will be no less than the amount of their benefit entitlement on January 1, 1979, under the old formula. The Administration would do this only for retirees and only for a five-year period. We urge a transition period of at least ten years for all beneficiaries—disabled and survivors as well as retirees. This was recommended by the Ford Administration. We are deeply disappointed the present Administration apparently does not intend to do the same.

OTHER PROPOSALS

In addition to these major proposals, President Carter's program for Social Security includes the following:

Shifts revenues from the Hospital Insurance Trust Fund (Medicare) to the cash benefit trust funds. This shift will be possible because the President's proposals for Social Security financing and hospital cost containment will result in a surplus in the Medicare hospital trust fund.

Moves forward the date of a 1 percent increase in the payroll tax schedule for 2011 in present law. One-fourth of the increase would be applied in 1985 and the remaining three-fourths in 1990. Of course, if Congress found that these increases were not needed or wished to choose another source of financing such as general revenues, it could annul or postpone these future rate increases as it has often done in the past. It is our hope that this will be possible.

Increases the self-employed tax from 7 to 7.5 percent. This restores the historical relationship which existed before 1972 and the self-employed rates should be 1.5 times that paid by employees.

Changes certain technical provisions of the Social Security Act which differentiate on the basis of sex. The Supreme Court recently held that a husband is entitled to dependency status under his wife's earned benefits even if he had not been dependent on her income. Eligibility would be limited to the spouse with the lowest earnings over the previous three-year period.

We support these proposals which will help strengthen the financing of the program to the benefit of millions of Social Security beneficiaries.

The President's proposals will reduce the deficit projected by the Trustees' Report from 8.2 percent of payroll to a manageable 1.9 percent average deficit over 75 years. In our opinion, this deficit is unlikely to actually occur because we regard the assumptions of the Trustees' Report as unduly pessimistic.

The most sensible course at this time is for the Congress to enact the changes recommended by the Administration which will assure the financial soundness of the Social Security system into the next century. We should not try to totally solve the small long-range financing problem that remains but wait a little longer until we are able to judge the most important long-run variables with a greater degree of certainty.

The primary factor causing the long-run financing problem is the projected decline in the fertility rate resulting in a much smaller labor force in the future. In other words, the proportion of workers supporting beneficiaries will likely be much less in the next century. A higher proportion of the nation's production by active workers will have to go to support older people—assuming the two groups maintain the same relative living standards that now exist.

On the other hand, the increased portion of the nation's production that will go to the retired population will be offset to a considerable degree by a decline in the number of younger people being supported by the economy. There will be less expenditures for supporting children, for schools, for day care, etc., and society can, if it wishes, shift the economic savings to supporting the larger older population. In short, in any society, the population at work has to support those that can't work. Looking at the total economy, the economic burden for active workers will not really change that much. There will be an increased need to support older people largely offset by a reduction in the need to spend money for young people.

The financial gains that accrue to society as a whole by such compensating factors are little reflected in monetary gains to the program itself. Thus, the financial problem is not one faced as much by the nation or economy as a whole but arises from the circumscribed manner in which the Social Security system is financed. The system is based on a payroll tax on active workers and on employers. Exclusive reliance on this tax, if the ratio of retired people to those at work increases significantly, will require major increases in the tax to support retirees.

The problem is how to route some of these financial gains to society from a declining birthrate to the Social Security program to help pay for the higher costs required to support the elderly. Considered solely as a tax, the Social Security contributions are highly regressive on wage earners. It would be unfair to place the entire increased burden of supporting the elderly on wage earners and wage income. The best way to achieve greater tax equity and to translate financial gains elsewhere in the economy to increased revenue to the program is by general revenue contributions to the trust funds. We urge gradually increasing contributions from general revenues until at least one-third of the Social Security program is financed in this manner. This general revenue funding should provide for needed program improvements as well as any long-run deficit, which we regard as unlikely, that may occur after the enactment of the Administration proposals.

The reliability of any long-range actuarial assumption diminishes as the length of the projection period increases. There are enormous problems involved in making realistic economic projections for 75, 50 or even 25 years. In the last few years, long-term economic assumptions used in the Trustees' Report have been influenced significantly, perhaps unduly, by recent transient economic problems.

The 1973 Trustees' Report assumed that real wages would increase on an average over the next 2¼ percent per year, prices by 2¾ percent per year, and that women would have an average of 2.5 children during their child-bearing years. At that time, with this set of assumptions, the system was in actuarial balance. The 1977 report uses more pessimistic assumptions based on recent experience. Under these assumptions, real wages would increase by only 1¾ percent per year, prices by 4 percent and the fertility rate would be 2.1 per woman. These small changes account for about all of the projected deficit over that projected in the 1973 report. This is because even very small changes when compounded over 75 years have a major impact on long-run costs.

Experience has shown that projection of future population growth has often been wrong. Demographic experts always draw attention to the uncertainties which surround their assumptions and emphasize that it is not possible to make firm predictions. For example, in 1946 the best estimates were that the U.S. population in 1975 might be as low as 147 million or as high as 191 million. Yet, by 1975 the population had actually reached 213 million.

Even if the most pessimistic demographic forecasts occur, it does not necessarily follow that there will be a proportionately smaller future labor force to support Social Security beneficiaries. A smaller labor force may nevertheless be accompanied by a greater demand for labor. Experience has shown that the supply of workers expands to meet demand. Many older people now forced into retirement may be able to continue working. Smaller families may bring more women into the labor force than is now predicted since there will be fewer years when they are caring for small children.

We should make every effort to drive down our excessive unemployment rates closer to those of most other industrialized nations so that more people will be working and paying into the trust fund. Future productivity increases may average 2.5 or 3 percent a year instead of the pessimistic 1.75 percent assumed in recent cost estimates. Very minor variations in any of these factors when compounded over a period of 75 years would have a significant impact on the cost of the Social Security system.

We hope our statement concerning the financing of the Social Security program has been helpful. President Carter's recommendation would, if enacted, put the Social Security program on a sound financial basis now and into the next century. We are certain that American workers can have every confidence that this Subcommittee and the Congress will not only act quickly and favorably on the President's proposals but will continue to improve the program.

Statement by the AFL-CIO Executive Council on Social Security Coverage of State and Local Government Employees

Considerable concern has recently been focused on the withdrawal of state and local governments from Social Security coverage. Unlike the private employers and employees, state and local governments and their employees are covered on an elective basis and three public employers can unilaterally withdraw from the program. When they do, the state and local employees involved lose valuable Social Security protections.

Facing budget pressures, many state and local governments shortsightedly view withdrawal from Social Security as a solution and over 200 have notified the Social Security Administration of their intention to withdraw.

The AFL-CIO is deeply concerned about the adverse effects that these withdrawals will have on the benefit protections of the affected public employees. Future retirement benefits for these employees, survivor protection for widows and minor children, and disability and health protection can be lost or reduced.

The Social Security System has accumulated sizable accrued liabilities on behalf of state and local public employees whose employers are now withdrawing them from coverage. When this happens, these costs then fall on all other covered wage earners and employers who have to contribute more to the Social Security program in order to make up for the discontinued contributions of the states and localities.

The Social Security protection of public employees should not be wiped out by the unilateral action of their employers. Once coverage is elected, withdrawal should not be allowed. The Congress and the Administration should act immediately to correct this defect in the law by requiring public employers, whose employees are covered by Social Security, to maintain that coverage.

[Adopted by AFL–CIO Convention, San Francisco, Calif., October 1975]

Old Age, Survivors, Disability and Health Insurance

In 1976, the United States will commemorate the 200th anniversary of its birth. In these 200 years, this nation has created a vast and complex economy, made momentous discoveries in science and technology and developed a democratic universal educational system open to all. Yet its treatment of the aged, sick and poor falls far short of what other less affluent and less educated nations are doing for their citizens. America has the wealth, the institutions and the competence. All that is lacking is the will to act.

With some astonishment at even having to say so, we in the AFL-CIO affirm our support of the Social Security system. Recent attacks on the low level of benefits, scare stories that it is going bankrupt, impel us to express our confidence in the integrity and workability of the system.

Since 1935, when it was first established, Social Security has been a continuing concern of the American labor movement. Nearly half the money in the system's trust funds comes out of workers' wages. More than 19 million workers and their dependents receive retirement benefits and the labor movement is well represented among the nearly 12 million other beneficiaries of the program—disabled workers and their dependents, widows, widowers, and orphans.

Claims that the system cannot meet its payments have recurred with some frequency during the past 40 years. The latest fears have arisen out of exaggerated press accounts of the reports of the Social Security Trustees. We concur in the views of five former HEW Secretaries, Elliot Richardson, Robert H. Finch, Wilbur J. Cohen, John W. Gardner and Arthur Flemming, who have examined the latest charges and find them baseless. In a joint statement they issued recently they find no lessening of congressional commitment, and to grounds for believing the system cannot meet its obligation. The steady drop in the national fertility rate, if it continues, suggests that sometime in the next century a smaller group of workers will be supporting a growing group of older retired persons. The current rate of inflation and the increase in benefits, tied to the cost of living, suggest that an increase in income will be needed over the next 25 years to pay the cash benefits. But we agree with the Secretaries that the problem is manageable and does not constitute a financial crisis.

The purpose of the Social Security system today remains as it was in 1937 when U.S. Supreme Court Justice Benjamin Cardozo so aptly expressed it:

"to save men and women from the rigors of the poorhouse as well as from the haunting fear that such a lot awaits them when journey's end is near." The Social Security system is still the best instrumentality we have for achieving that purpose. To say that, however, does not mean the system cannot be improved.

To place this nation in the first ranks of leadership in social insurance protections for its citizens, the AFL-CIO recommends the following far-reaching reforms in the Social Security program.

COST OF LIVING ESCALATOR

Galloping inflation has had a disastrous impact on the living standards of Social Security beneficiaries. The present cost-of-living escalator providing for annual increases was based on the assumption that price increases would be moderate and skyrocketing prices were not anticipated. More rapid adjustment of benefits is needed to keep up with rising prices. Therefore, benefits should be adjusted for the rise in living costs at least every six months whenever the Consumer Price Index increases by 3 percent or more.

One major handicap in the effort to fight inflation among Social Security beneficiaries is the lack of a budget that accurately measures the impact of inflation on them. While the present Consumer Price Index best applies to workers and should be continued, a special Consumer Price Index should be devised for the elderly which would better reflect the cost increases in the items that make up their typical budget.

SEX DISCRIMINATION

The same legal rights in all respects should flow from a worker's wage record regardless of whether that worker is male or female. Therefore, all differences in the benefit treatment of men and women should be removed from the law, thereby improving the benefit protection for married women who work and the treatment of couples where both work.

RETIREMENT AGE

The impact of automation and unemployment has created serious problems for elderly workers who are not yet 65 and therefore not eligible for full Social Security benefits. A number of changes should be made in the Social Security Act to more effectively meet the interrelated problems of old age, disability and unemployment.

1. The Social Security Act should be amended to include an occupational definition of disability for older workers so that any disabled worker after 50 or 55 who is unable to handle his or her usual occupation would be entitled to Social Security disability benefits.
2. Because of unemployment and the low wage base in earlier years, most workers retire on low Social Security benefits not adequately related to wages at the time of retirement. At present, workers can drop out only five years of low or no earnings in computing their average wage on which their benefits are based. The number of drop-out years of low or no earnings in computing the average wage base should be increased as a first step toward a benefit formula based on a worker's high 5 or 10 years of earnings.
3. A serious problem has been the low, actuarially reduced benefits of those who are forced to retire before age 65. Retirement before age 65 is possible but only with a severe actuarial reduction. The law should permit retirement between 60 and 65 with less than a full actuarial reduction in benefits.
4. In addition to lowering the retirement age in this manner, there is a dire need for economic protection for older workers before eligibility for retirement benefits in case of persistent unemployment. Workers who are unemployed for two full years after age 55 should be entitled to Social Security benefits on the same basis as if they had reached the minimum age of eligibility for retirement benefits.

TEMPORARY TOTAL DISABILITY

Social Security disability benefits are not paid unless individual is totally disabled for at least six months and unless he or she meets the excessively stringent definition that the disability is totally incapacitating and will last at least 12 months or is expected to result in death.

This means that many workers are incapacitated for months without either regular income or benefits. The economic impact on the family can be catastrophic, causing deprivation that may last years beyond the date of recovery of the breadwinner.

The Social Security Act should be amended so that benefits will be paid for total disability that lasts longer than one month without regard to its subsequent expected duration. This coverage should apply equally to working women who must cease work temporarily before and after pregnancy.

MEDICARE

Pending enactment of National Health Security, the Medicare program should be expanded to provide older and disabled people greater protection for health costs. Among the needed improvements are:

1. Elimination of the monthly premium beneficiaries must pay for Part B (physician services) of Medicare.
2. Coverage of prescription drugs.
3. Reduction or elimination of the requirement that a disabled beneficiary must receive cash benefits for two years as a condition for eligibility for Medicare coverage.
4. Coverage for all Social Security beneficiaries before age 65 who retire or are forced out of the labor market because of unemployment.
5. Enactment of long-term care program for Social Security beneficiaries without means or income tests as part of either Medicare or a national health program.

FINANCING

Though the worker receives an economic bargain in terms of benefits received for contributions paid, the Social Security tax has become a burden for many workers. Since the contribution rate is uniform for all salary levels and exempts higher levels of income, considered solely as a tax it is regressive. The Social Security tax should not go higher. Instead, future Social Security improvements should be financed by increases in the earnings base and by a gradually increasing general revenue contribution.

We reaffirm the position taken in the Executive Council statement of February 1975 that the Social Security tax should be applied to the total payroll of employers and that a new benefit formula should be adopted which would better reflect wages earned at the time of retirement.

SUPPLEMENTAL SECURITY INCOME (SSI)

The Supplemental Security Income Program has serious deficiencies which must be corrected. Although it was known in advance that this program would be exceedingly complex and cover millions of impoverished elderly, blind and disabled, the Administration deliberately failed to request funds for anywhere near sufficient staff to launch the program on an effective and equitable basis. The result has been vast confusion involving substantial errors in payments and much hardship for many beneficiaries of the program.

We call upon the Administration to immediately request funds for additional staff to assure fair and effective administration of the program. Beneficiaries must not be made to suffer because of maladministration of the program. Therefore, rebates from the meager amounts recipients receive must not be required even if previous benefits they have received were technically overpaid.

But inadequate staff to properly administer the program is not the only problem. Benefit levels are too low so that recipients are unable to live decently on them. The goal should be to guarantee these deprived Americans a SSI benefit sufficient to lift them from poverty.

The problem of inadequate benefits is compounded since SSI beneficiaries often lose their eligibility for other public benefits, such as food stamps and Medicaid, when their income rises due to cost of living or Social Security increases. Congress should enact a "pass-through" provision to meet this problem.

Similarly, states that supplement federal SSI payments should not be allowed to decrease their supplements by the dollar amount of federal increases. These states should be required to "pass-through" federal SSI increases and any resulting additional costs incurred by a state should be shared by the federal government.

INDEPENDENT SOCIAL SECURITY AGENCY

We affirm the position taken in the Executive Council statement of Aug. 6, 1974 that the Social Security Administration should be an independent, nonpolitical agency. It should be under the direction of a five-member governing board, including duly designated representatives of management and labor, appointed by the President with the advice and consent of the Senate and with no more than three members from any one political party. At the same time, in order to strengthen public confidence in the program, the Social Security trust funds should be excluded from the unified budget.

Senator NELSON. Our next witness is Melvin Glasser, director of the social security department, International Union, United Automobile, Aerospace and Agricultural Implement Workers of America.

We appreciate having you here this morning, Mel. Can you present your testimony in a 20-minute period?

Mr. GLASSER. Most assuredly.

Senator NELSON. Your full prepared statement will be printed in the record. You can avoid repetition of statistics that we already had.

Would you identify your associate for the reporter?

Mr. GLASSER. May I introduce Dr. William Hoffman, who is my associate in the social security department of the UAW. We are speaking today on behalf of 1½ million members. We represent about 5 million people who are in the UAW families.

STATEMENT OF MELVIN A. GLASSER, DIRECTOR, SOCIAL SECURITY DEPARTMENT, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, ACCOMPANIED BY DR. WILLIAM HOFFMAN, ASSOCIATE, SOCIAL SECURITY DEPARTMENT, UAW

Mr. GLASSER. Mr. Chairman, the workers who make up the membership of our union have intense interest in the continued financial integrity of this program. The paychecks they earn include deductions for social security. Their contributions combine with those of over 100 million other Americans to pay for the benefits of those already retired. They are deeply concerned that the money they pay to social security does not stretch far enough to cover even the too frequently inadequate benefits paid to current retirees and their dependents. They know they earn future benefit protection by contributing during their working years. But, after years of continued confidence in their Government's promise of social security, they are beginning to have doubts. Tens of thousands of our members retire each year. The issues of financing social security are of critical importance to their lives.

At present, there are approximately 300,000 retired UAW members. We can tell you that they are also deeply concerned. Our retirees and their dependents count heavily on their social security checks. This is especially true for our members who have retired from some of the less profitable companies. Social security often constitutes the major portion of their retirement income.

For several years now we have seen the issues of financing social security debated in the press. Scare stories based upon inaccurate and misleading information have caused great public concern.

The very continued existence of the program is widely questioned among working people. They do not believe it may continue. We have talked to them across the country. Our members and all of America's workers, retirees and their families, are waiting for the strengthening of this system. They feel, and we believe quite rightly, that it is their program. They have a very personal stake in what happens here.

We appreciate, Mr. Chairman, the prompt action of this committee in scheduling these hearings. However, we are deeply concerned that some Members of the Congress are already saying that this is not the time to face the mid- to long-range fiscal problems confronting social security. They say patch up the short-term problems, study the long-range concerns. We say that this is the wrong approach.

The system is in financial trouble. You know the figures and you know that it is going to go broke before long. The system needs to be restored and made financially viable.

You have heard from the AFL-CIO and the various other groups which have studied the system and made recommendations. We strongly believe that the present and continued fiscal unbalance must be corrected now. We do not need further study.

American workers must be secure in the knowledge that the benefits they earn and that they will earn will be paid.

The Carter administration, within 5 months of taking office, reviewed the findings of numerous social security financing reports and studies. They consulted experts, examined recommendations, and presented a series of proposals. We believe that all of us should be thankful for the administration's insightful and constructive proposals to strengthen social security financing. The people know that we must face the facts now. The administration has provided leadership. This committee has acted promptly. We hope the Congress will resolve this major national concern.

The President detailed his comprehensive proposals with which you are familiar. First is counter-cyclical general revenue financing to compensate the trust funds for income lost due to unemployment. We support this proposal. It is a modest but important start. The shift of Treasury funds to social security during a recession provides needed support for the program when an income shortfall cannot be made up through increased taxes. Increasing taxes at such times would risk deepening the economic downturn. Underwriting deficits in the manner proposed also allows a reduction in the trust funds reserve level without a loss of fiscal security.

General revenue financing is long overdue. While we support the proposal before this committee, tying Treasury support to a level of unemployment is too restrictive. We believe it essential that over time and with advanced planning, Congress should move toward more substantial general revenue support. Average social security benefits for retired workers only amounted to $225 of primary benefit in 1976. Such benefits do not provide adequate income loss protection. Clearly, means must be found to establish sufficient financing to support decent benefit levels.

A review of the social security program in other countries indicates that many—including Germany, Japan, Canada, Brazil, Aus-

tralia, Denmark, Ireland, Israel, Netherlands, Italy, Philippines, Spain, Britain, and Luxembourg—employ general revenue financing. Some countries, notably the Netherlands, Ireland, Australia, and Brazil, specifically assign the cost of any program deficits to general revenues.

At present, under our system, the average income replacement rate of social security benefits for a retiree is 38 percent. This figure compares with 46 percent in France, 50 percent in Germany, and 67 percent in Italy. Surely this great Nation must improve the financial security of its retired workers. The people whose efforts throughout their working lives have helped build our prosperous economy deserve adequate retirement income. But, it is clear that we can't provide workers with a secure retirement in dignity unless general revenue financing is provided.

Workers are concerned with the regressivity in the social security tax structure. The use of general revenues is one way to reduce this unfair burden. Yet, in some quarters general revenue financing is criticized as introducing a welfare component to the social security cash benefit programs. We cannot understand the basis for this criticism. We are not calling for a change in eligibility criteria. We are not calling for a change in the contributory basis for determining benefits and entitlement. We do, however, recognize that an increased financial burden requires additional funds.

General revenue financing is not a new concept. The original framers of the social security bill, as you know, anticipated that it would be required by the mid-1960's, and in fact, Congress acted on this in 1944 but later did not implement it [the recommendation].

Second, is removal of the wage base ceiling on employer taxes in three steps. We support this proposal as giving long overdue recognition of employers' responsibility to provide more adequate support for the retirement benefits of worker families. Members of this committee are aware that only 35 million workers in this country are covered by private pensions. Nearly two-thirds of the private work force are not.

Senator Nelson. May I ask a question there?

That figure is 35?

Mr. Glasser. Yes, sir.

Senator Nelson. When you say private, you are excluding State and municipal governments?

Mr. Glasser. Yes; I am talking about private employer-employee.

Senator Nelson. All right.

Mr. Glasser. These workers depend substantially upon social security for their retirement incomes.

Even those who have private pension plan protection rely on social security. Most private pensions are designed to take into account social security benefits. Illustrations of this can be found in the benefits provided in the pensions negotiated by our union with the Big Three automobile companies. Yet, thousands of our members, it must be said, have far less income protection than that provided in our contracts with the more profitable companies. The benefits these workers earn under social security are essential to their secure retirements.

We are convinced this is a fair proposal. The cost to employers is about $4 billion less than the projected employer contributions which would result from the approach of increasing both the tax rate and wage base.

Senator NELSON. Is that under current provisions of law?

Mr. GLASSER. Yes. The numbers over 4 years are $34.2 billion, if one increased the tax rate and base, and $30.4 billion over 4 years if one follows the administration's proposal.

And while I am commenting on this, Senator Nelson, may I answer a question that you asked of Mr. Biemiller in another way?

You asked if certain groups of employers would be better off or worse if the administration's proposal to tax full payroll would be implemented.

We believe that the marginal employers, the smaller employers, particularly in the service industries, would be better off with the administration's proposal since their wages tend to be the lower wages. Their payrolls, basically, are almost 100 percent taxed now. They would not get the impact of full payroll in the way the larger, more profitable employers are likely to be taxed. That is a generalization, which, of course, has exceptions.

Senator NELSON. Well, then, you do agree with the response given by Mr. Biemiller that it would have to be a very high salaried company in order for it to cost more? Is that correct?

Mr. GLASSER. That is correct. In most instances, it ought to be a larger company with a larger range of salaries than you usually see in the service industries.

Further, employer contributions to social security are considered as business expenses and therefore deductible from their corporate income taxes. The proposal is a reasonable approach to generating needed revenues. The fiscal integrity of the system would be strengthened without increasing the program's benefit liability.

Third, we support restoring the traditional ratio in the tax rate of the self-employed. The self-employed enjoy the same benefit protection as those who receive wages, and we support the restoration of the traditional equitable ratio of the tax rate for the self-employed to the rate paid by employed workers.

Fourth, we support increasing the wage subject to social security tax beyond the existing projected increases by $2,400 by 1985.

We recognize middle-income wage earners are not happy with the prospect of increased taxes as this measure would require. We believe, however, that such workers would be prepared to accept this proposal. It would decrease the regressivity in the social security tax structure and would yield higher earned benefits. In 1937, when social security contributions started, about 97 percent of all those in covered employment had their full earnings counted for social security. Today, the comparable figure is 85 percent. This proposal would go a long way to restoring the original relationship by covering the earnings of all but the highest paid.

The proposal is equitable. It would require higher contributions from those with the greatest ability to pay. Those who contribute more would earn higher benefits in retirement. There is evidence that higher paid workers need greater income-loss protection. Their needs

are not presently being met adequately. Further, the increased revenues, estimated to amount to $9.3 billion by 1985, which would result from increasing the taxable wage base, would provide needed financial support during the short term.

It is also important to compare this proposal with one which would increase the existing social security tax rate level. At present, the low wage earner and even the midlevel wage earner contribute to social security on the basis of 100 percent of their wages. Yet, the highest paid workers contribute on a lower portion of their earned income. A tax rate increase would only aggravate this regressive burden—a burden which is especially severe for those with the least ability to pay. Furthermore, a tax rate increase by itself results in no increase in the benefit levels of those who pay more. It is clearly more equitable to increase the wage base in the manner proposed by the Administration.

We continue to be concerned with the heavy burden social security taxes represent for the lowest wage earners. Consideration should be given to providing income tax credits for the social security taxes paid by wage earners whose annual incomes are below the poverty level. However, since we understand that this is to be taken up under tax reform measures, we mention our concern here to make certain that this critically important issue is resolved.

Fifth, we support shifting a portion of the income generated by the already scheduled 1978 and 1981 hospital insurance tax rate increases to the cash benefit programs. It would bolster the cash benefit programs, especially disability insurance, and is a reasonable, partial solution to the fiscal problems confronting the system.

The proposal appears sound, but it will not continue to be sound if health care costs continue to escalate at the present rate. And that is a serious problem.

Sixth, we support establishing a new eligibility test for dependents' benefits.

We support the administration proposal to apply the same eligibility criteria to husbands and wives. Social security benefits are designed to provide family breadwinners' income replacement. An equally applied dependents' test is consistent with this program principle.

These six proposals, if enacted this year, would result in resolving social security's financing problems over the short run. As the administration has indicated, income to the program would then exceed expenditures beginning in 1978. The exhaustion of the disability insurance trust fund in 1979 would be averted. The old age and survivors insurance test fund would remain viable beyond 1983 with a restored adequate reserve level. And, these necessary goals would be accomplished without any increase in the existing schedule tax rates.

Yet, even with the early enactment of these proposals, financing problems would still confront social security into the next century. And this is where we urge the committee to act now.

The mid- to long-range problems are not speculative. We know they will exist. There is no need for further study. In fact, delays only increase the problems and make their resolution that much more difficult.

The administration recommends two proposals which would insure the financial integrity throughout the remainder of this century and establish the fiscal soundness in the programs. Additional modifications could be made after 2001 if the need for increased income is apparent.

We support the administration's proposal to advance the 1-percent tax rate increase scheduled for 2011. The advanced scheduled increased revenues will be needed.

We have supported and continue to support the 1972 landmark amendments to the Social Security Act which recognized the need to keep retirement income insulated from erosion due to inflation. We also support "decoupling" or correcting the technical error which provides an unintended double dip for inflation in the future benefits of those now working. However, the correction process must be done without reducing the already inadequate wage replacement rates, as Mr. Biemiller has testified.

I would like to depart from the prepared testimony and indicate that we are also in support of the AFL–CIO position of no change in replacement rates until 10 years from now, and we have a very specific reason for indicating this.

The UAW has major, early retirement programs. We have tens of thousands of workers, probably approaching over 100,000 now, who, between the ages of 50 and 62, have left the work force in the last 10 years. The largest numbers have left in the last 3 or four years. We have a workman's test, which is identical with the social security test. So they left the work force, based upon the expectation that the UAW negotiated pension in combination with the expected social security income they will receive over the next years, will give them an adequate means of living in respectable retirement.

Changing that anticipated income at this point would be deleterious to them and would be, in fact, a change from their expectations of what they could get out of retirement income. That would be a major problem for these people. Therefore, the 10-year moratorium, if you would like to call it that, is needed.

In summary, on behalf of our members and their families, we call upon your committee to recommend early enactment of the administration's proposals. They will strengthen social security. They will deal with the immediate as well as the mid- and long-range problems. We believe they are interrelated and we urge early action.

Thank you, sir.

Senator NELSON. Mr. Long?

Senator LONG. No questions at this point. Thank you very much.

Senator NELSON. Mr. Danforth?

Senator DANFORTH. No questions. Thank you.

Senator NELSON. What percentage of the United Auto Workers are covered by private pensions now?

Mr. GLASSER. It is in excess of 90 percent.

Senator NELSON. Do you have an average figure of what the replacement percentage amounts to when combined with current social security benefits?

Mr. GLASSER. I anticipated that question but I regret to advise you I cannot give you an answer. The differences in the rates of

retirement and the differences in benefits dating back to 1950, and the differences in the employers—we have 1,500 pension plans—are such that I cannot answer that question.

I can answer it for the Big Three, but that is not a representative answer.

Senator NELSON. I must say that you have great insight because you anticipated a question that I hadn't determined to ask until this moment.

Thank you very much.

Mr. GLASSER. You are very welcome.

[The prepared statement of Mr. Glasser follows:]

STATEMENT OF MELVIN A. GLASSER, DIRECTOR, SOCIAL SECURITY DEPARTMENT, INTERNATIONAL UNION UAW, IN BEHALF OF INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW

Summary of Principal Recommendations

Immediate Congressional action is needed to strengthen social security financing into the next century. Short term changes alone would be unsatisfactory.

Counter-cyclical general revenue financing of social security constitutes an important initial step toward the goal of more substantial general revenue support.

Correction of the unintended double impact of inflation on the benefits of future retirees must be undertaken as soon as possible without any reduction in replacement rates.

Employers should contribute to social security on the basis of total payrolls.

The wage-contribution base for workers should be increased beyond the levels resulting from the projected automatic increases.

A portion of the revenues generated by the scheduled Hospital Insurance tax rate increases should be used to support the cash benefits' programs.

The tax rate for the self-employed should be restored to the traditional level of one and one-half times the rate for employed workers.

The tax rate increase scheduled for 2011 should be made effective sooner.

The criteria for determining eligibility for dependents' benefits should be equitably applied to men and women.

Mr. Chairman, Members of the Subcommittee on Social Security; my name is Melvin A. Glasser, Director of the International Union, UAW's Social Security Department. Accompanying me is Dr. William S. Hoffman, my associate from the UAW Social Security Department. We appreciate the opportunity to present testimony on maintaining the fiscal soundness of Social Security. We speak for over one and one half million active and retired members of the UAW who, together with their families, constitute about 4 and one-half million Americans.

The workers who make up the membership of our Union have intense interest in the continued financial integrity of Social Security. The paychecks they earn include deductions for Social Security. Their contributions combine with those of over 100 million other American workers to pay for the benefits of those already retired. UAW members are deeply concerned with the money they pay to Social Security does not stretch far enough to cover even the too frequently inadequate benefits paid to current retirees and their dependents. They know they earn future benefit protection by contributing during their working years. But, after years of continued confidence in their government's promise of social security they are beginning to have doubts. Tens of thousands of our members retire each year. The issues of financing social security are of critical importance to their lives.

At present, there are approximately 300,000 retired UAW members. We can tell you that they are also deeply concerned. Our retirees and their dependents count heavily on their social security checks. This is especially true for our members who have retired from some of the less profitable companies. Social security often constitutes the major portion of their retirement income.

For several years now we have seen the issues of financing social security debated in the press. Scare stories based upon inaccurate and misleading

information have caused great public concern. The very continued existence of the program seemed in question. We have talked to workers across the country. Their confidence in Social Security has been shaken. Our members and all of America's workers, retirees and their families are waiting for the strengthening of the financing of the system. They feel, and quite rightly, that it is their program. They have a personal stake in whatever action Congress takes.

Mr. Chairman, we appreciate the prompt action of this Committee in scheduling these hearings. However, we are deeply concerned that some members of Congress are already saying that this is not the time to face the mid- to long-range fiscal problems confronting Social Security. They say patch up the short term problems, study the long-range concerns. We say that is the wrong approach.

The system is in financial trouble. The Disability Insurance Trust Fund reportedly will be exhausted in 1979. The Old Age and Survivors Insurance Funds will be depleted shortly thereafter. Even after short term solutions are enacted, a fiscal imbalance will remain into the next century. The system obviously needs restored, strengthened financing to keep it viable.

The 1975 Report of the Social Security Advisory Council carefully spelled out the problems. The last three Trustees Reports of the Social Security Trust Funds have repeated and updated the financing concerns. Congress has held a number of hearings in recent years on the subject. Numerous responsible government and private organization spokesmen have offered detailed testimony. We strongly believe that the present and continued fiscal imbalance must be corrected now. We don't need further study. American workers must be secure in the knowledge that the benefits they earn now, will earn and have earned, will be paid.

The Carter Administration, within five months of taking office reviewed the findings of numerous social security financing reports and studies. They consulted experts, examined recommendations and developed the series of proposals presently before this Committee. All Americans should be thankful for the Administration's insightful and constructive proposals to strengthen Social Security financing. The people know we must face facts now. The Administration has provided the leadership. This Committee has acted promtply in scheduling these hearings. We now call upon Congress to resolve this major national concern.

In a May 9, 1977 message to Congress, President Carter detailed his comprehensive proposals for strengthening Social Security financing. These include:

First. Counter-cyclical general revenue financing to compensate the trust funds for income lost due to unemployment.

We support this Administration proposal. It is a modest but important start. The shift of treasury funds to social security during a recession, provides needed support for the program when an income shortfall cannot be made up through increased taxes. Increasing taxes at such times would risk deepening the economic downturn. Underwriting deficits in the manner proposed also allows a reduction in the Trust Funds reserve level without a loss of fiscal security.

General revenue financing is long overdue. While we support the proposal before this Committee, tying treasury support to a level of unemployment is too restrictive. We believe it essential that over time and with advanced planning, Congress should move toward more substantial general revenue support. Average social security benefits for retired workers only amounted to $225 per month in 1976. Such benefits do not provide adequate income-loss protection. Clearly, means must be found to establish sufficient financing to support decent benefit levels.

A review of the social security programs in other countries show that many, including Germany, Japan, Canada, Brazil, Australia, Denmark, Ireland, Israel, Netherlands, Italy, Philippines, Spain, Britain and Luxembourg, employ general revenue financing. Some countries notably the Netherlands, Ireland, Austria and Brazil, specifically assign the cost of any program deficits to general revenues.

At present, under our system the average income replacement rate of Social Security benefits for a retiree is 38 percent. This figure compares with 46 percent in France, 50 percent in Germany, and 67 percent in Italy. Surely this great nation must improve the financial security of its retired workers. The people whose efforts throughout their working lives have helped build our

prosperous economy deserve adequate retirement income. But, it is clear that we can't provide workers and a secure retirement in dignity unless general revenue financing is provided.

Workers are concerned with the regressivity in the Social Security tax structure. The use of general revenues is one way to reduce this unfair burden. Yet, in some quarters general revenue financing is critized as introducing a welfare component to the Social Security cash benefit programs. We cannot understand the basis for this criticism. We are not calling for a change in eligibility criteria. We are not calling for a change in the contributory basis for determining benefits and entitlement. We do, however, recognize that an increased financial burden requires additional funds.

General revenue financing is not a new concept. Under present law, such monies are already transferred to Social Security to provide hospital insurance for those not eligible for cash benefits, to pay half the cost of Medicare Part B, to defray the cost of benefit payments due to credits earned in military service, and to provide special benefits to those over age 72 who are not able to meet the normal entitlement provisions of the Act.

The original framers of the Social Security bill anticipated the program would require general revenue support by the mid-1960s. Over the years, various responsible groups have advocated general revenue financing and several Social Security Advisory Councils have recommended such action. In 1944, Congress passed the Vandenburg-Murray Amendment to the Social Security Act which authorized general revenue underwriting of future deficits. The authorization was not implemented and the amendment was repealed in 1950.

Second. Removal of the wage base ceiling on employer taxes in three steps.

We support this proposal as giving long overdue recognition of employers' responsibility to provide more adequate support for the retirement benefits of worker families. Members of this Committee are aware that only 35 million workers in this country are covered by private pensions. Nearly two-thirds of the private workforce are not. These workers depend substantially upon Social Security for their retirement incomes.

Even those who have private pension plan protection rely on Social Security. Most private pensions are designed to take into account Social Security benefits. Illustrations of this can be found in the benefits provided in the pensions negotiated by our Union with the Big Three automobile companies. Yet, thousands of our members, it must be said, have far less income protection than that provided in our contracts with the more profitable companies. The benefits these workers earn under Social Security are essential to their secure retirements.

We are convinced this is a fair proposal. The cost to employers is about $4 billion less than the projected employer contributions which would result from the approach of increasing both the tax rate and wage base. Further, employer contributions to Social Security are considered as business expenses and therefore deductible from their corporate income taxes. The proposal is a reasonable approach to generating needed revenues. The fiscal integrity of the system would be strengthened without increasing the program's benefit liability.

Third. We support restoring the traditional ratio in the tax rate of the self-employed.

From 1950 until 1972, the Social Security tax rate paid by the self-employed was equal to 1½ times the rate paid by employed wage earners. This relationship has eroded since 1972. The self-employed enjoy the same benefit protection under Social Security as those who receive wages. We support the restoration of the traditional and equitable relationship of the tax rate for the self-employed to the rate paid by employed workers.

Fourth. Increase the wage subject to Social Security tax beyond the existing projected increases by $2,400 by 1985.

We recognize middle income wage earners are not happy with the prospect of increased taxes as this measure would require. We believe, however, that such workers would be prepared to accept this proposal. It would decrease the regressivity in the Social Security tax structure and would yield higher earned benefits. In 1937, when Social Security contributions started, about 97 percent of all those in covered employment had their full earnings counted for Social Security. Today, the comparable figure is 85 percent. This proposal would go a long way to restoring the original relationship by covering the earnings of all but the highest paid.

The proposal is equitable. It would require higher contributions from those with the greatest ability to pay. Those who contribute more would earn higher benefits in retirement. There is evidence that higher paid workers need greater income-loss protection. Their needs are not presently being met adequately. Further, the increased revenues, estimated to amount to $9.3 billion in 1985, which would result from increasing the taxable wage base, would provide needed financial support during the short term.

It is also important to compare this proposal with one which would increase the existing Social Security tax rate level. At present, the low wage earner and even the mid-level wage earner contribute to Social Security on the basis of 100 percent of their wages. Yet, the highest paid workers contribute on a lower portion of their earned income. A tax rate increase would only aggravate this regressive burden—a burden which is especially severe for those with the least ability to pay. Furthermore, a tax rate increase by itself results in no increase in the benefit levels of those who pay more. It is clearly more equitable to increase the wage base in the manner proposed by the Administration.

We continue, however, to be concerned with the heavy burden Social Security taxes represent for the lowest wage earners. Consideration should be given to providing income tax credits for Social Security taxes paid by wage earners whose annual incomes are below the poverty level. However, since we understand that this is to be taken up under tax reform measures, we mention our concern here to make certain that this critically important issue is resolved.

Fifth. Shift a portion of the income generated by the already scheduled 1978 and 1981 Hospital Insurance tax rate increases to the cash benefit programs.

We support this reassignment of program income within the existing tax schedule. The Hospital Insurance program is operating at a surplus. Future revenue is expected to result from the proposed and existing automatic wage base increases, and the removal of the wage base ceiling on employer contributions. The shift of funds to bolster the cash benefit programs, especially Disability Insurance, is a reasonable partial solution to the fiscal problems confronting the total Social Security system. The proposal appears sound. But it will not continue to be sound if health care costs continue to escalate at their present rate.

Sixth. Establish a new eligibility test for dependents' benefits.

We support the Administration proposal to apply the same eligibility criteria to husbands and wives. Social Security benefits are designed to provide family breadwinners' income replacement. An equally applied dependents' test is consistent with this program principle.

These six proposals, if enacted this year, would result in resolving Social Security's financing problems over the short run. As the Administration has indicated, income to the program would then exceed expenditures beginning in 1978. The exhaustion of the Disability Insurance Trust Fund in 1979 would be averted. The Old Age and Survivors Insurance Trust Fund would remain viable beyond 1983 with a restored adequate reserve level. And, these necessary goals would be accomplished without any increase in the existing scheduled tax rates.

Yet, even with the early enactment of these proposals, financing problems would still confront Social Security into the next century. The mid- to long-range problems are not speculative. We know they will exist. There is no need for further study. In fact, delays only increase the problems and make their resolution that much more difficult.

The Administration recommends two proposals which would ensure the financial integrity throughout the remainder of this century and establish the fiscal soundness in the programs. Additional modifications could be made after 2001 if the need for increased income is apparent.

We support the Administration's proposal to advance the 1 percent tax rate increase scheduled for 2011. The advanced scheduled increased revenues will be needed.

We have supported and continue to support the 1972 landmark amendments to the Social Security Act which recognize the need to keep retirement income insulated from erosion due to inflation. We also support "decoupling," or correcting the technical error which provides an unintended double dip for inflation in the future benefits of those now working. However, the correction process must be done without reducing the already inadequate wage replacement rates.

In summary, on behalf of UAW members and their families, we call upon your Committee to recommend early enactment of the Administration's proposals for strengthening the financing of Social Security. Each of the eight items in the Administration's message to Congress on Social Security financing is sound. Taken together, the package represents a logical and basically fair resolution to the fiscal problems reported in the latest Trustees' Report. Furthermore, the proposals maintain the principles upon which the program was founded. They will help restore public confidence in the structurally sound and socially essential programs which constitute Social Security

Senator NELSON. Our next witness is Nelson Cruikshank, president of the National Council of Senior Citizens, Inc.

The committee is pleased to see you here today, and your statement will be printed in full in the record. You may present it however you desire.

STATEMENT OF NELSON H. CRUIKSHANK, PRESIDENT, NATIONAL COUNCIL OF SENIOR CITIZENS, INC., ACCOMPANIED BY BETTY DUSKIN, DIRECTOR OF RESEARCH

Mr. CRUIKSHANK. Thank you, Mr. Chairman, members of the committee, and Chairman Long.

My name is Nelson H. Cruikshank. I am president of the National Council of Senior Citizens, and I am accompanied by our director of research, Mrs. Betty Duskin.

The National Council is a nonprofit, nonpartisan organization of more than 3,800 older people's clubs in all 50 States, representing over 3 million members.

I deeply appreciate the opportunity to comment on the administration's proposals for strengthening the financial structure of the social security system, the most successful social program in the history of our Nation.

At our recent legislative conference, which was attended by thousands of elected delegates from senior citizens' clubs across the Nation, members of the National Council of Senior Citizens asked the leadership of the council to inform Congress that the elderly constituency which we represent stands solidly behind the President's social security financing proposals. Our members urge you to restore public confidence in the social security system by enacting the administration's constructive and practical financing remedies and to do so as soon as possible.

For the past several years, senior citizens have been bombarded by alarms and scare stories to the effect that the social security system was not soundly financed. Some critics went so far as to proclaim that in the next few years, the system would either go broke or have to reduce benefits. However, we know that the Congress is not going to break faith with people by permitting their social security benefits to be jeopardized.

As the committee is aware, the nature of the financing difficulties is properly separated into two distinct aspects: The first involves a short-run cyclical deficit, and the second relates to the forecast of a long-run imbalance, part of which is structural in character.

The reasons for the short-run problem are the simultaneous high unemployment and the high inflation rates of the last several years. High unemployment causes total dollar wages to fall, and this causes a decline in contributions to the system. Inflation, on the other hand,

causes total benefit outlays to rise, since benefits are automatically adjusted upwards as the cost of living rises. Unemployment also forces many workers to accept early retirement at reduced benefits. A great many of them would prefer to continue working. While the reduction in their benefits spread over time means no actuarial loss to the system, this present retirement status is reflected in the short-run outflow of funds. Thus, the short-run problem cannot be blamed on the social security system, but on the malfunctioning economy. Indeed, it is in large measure a remedy, both for the economy and for older people caught in the squeeze between unemployment and inflation.

The long-run problem is a result of two unrelated difficulties. One is a technical, but easily correctable error in the automatic cost-of-living adjustment which, under some circumstances, may intentionally overcompensate retirees in future years.

The second problem arises from anticipated demographic changes early in the 21st century. The projected changes indicate that the retirement age population will be much larger due to the baby boom of the late 1940s and 1950s while the working age population will not grow similarly if the lowered birth rates of recent years continue into the future. Assuming that there are no adjustments in labor force participation or no unexpected changes in birth rates, this could mean that proportionately fewer workers will be required to support a relatively larger retired population than is currently the case. Given all the uncertain guesses which prophets use to foretell the future, the anticipated problems may be exaggerated. But again, the social security system is not the problem; it is the answer. Those persons born during the baby boom period will be with us early in the next century and they will be in need of a system of income maintenance when they reach retirement age. Obviously, though it sometimes seems to be overlooked, they would be here with their needs even if we did not have a social security program.

Clearly, the underlying causes of the current and projected financial difficulties are economic, demographic and technical in nature—salted and peppered with a large amount of speculation. It is important to understand that none reflects on the interest merit of the social insurance principle, or on the inherent soundness of the social security system. The problems of short-run deficits and the technical flaw in the automatic provisions are readily correctable. The problem of the speculated rise in the ratio of retirees to labor force participants—if it can be called a problem at all—is not unique to the social security program; it confronts any society which protects its elderly, its disabled, and its dependent survivors against economic insecurity.

And I might add that it would confront any program that anyone might conceive to replace social security. There are some, who conceive that there should be another system. They base their argument on the existence of these problems, but these factors will be here no matter what system we develop to meet the needs of our population.

Recognition of the causes of the financial problems of the social security system presents strong arguments—not for the weakness of the system, but for its strength.

First, it acts as an offset to recession by generating those same deficits for which it is criticized.

Second, rather than suggesting that the system will be subjected to alarming difficulties in the 21st century, the growth in size of the older population suggest that the social security system is destined to play an even greater role in the future than it has in the past.

It is, therefore, of crucial importance that any changes to this system be carefully devised with full knowledge and understanding of the intent and functioning of the program.

The National Council for Senior Citizens feels that the President's financing proposals fulfill these criteria. The proposals operate within the existing benefit structure; they are philosophically consistent with the nature and intent of the program; they are equitable; and they are appropriately cautious and flexible.

There is also wisdom inherent in providing for the financial integrity of the social security system up through the turn of the century which the President's proposals do, but in not attempting to remove the entirety of the forecast long-run, 75-year deficit—although the estimated residual deficit is modest. The reasons for this are twofold: The first, Mr. Chairman, concerns the imperfect knowledge with which forecasts are made and therefore, the imperfect description of the nature and size of the problem. We cannot and should not make policy that attempts to fully adjust a problem in the distant future that is only dimly perceived in the present.

Second, the understanding is implicit that all of the difficulties that are conventionally ascribed to the social security system may not be properly specified in this context. They are problems of society at large, and some may be better resolved outside of the social security system. I shall come back to this point again.

As this committee is aware, the proposals which address the short-range and mid-range problems include: One, infusing countercyclical general revenues when unemployment exceeds 6 percent, effective 1978 to 1982, applied to the short-fall of 1975 to 1987; two, phasing-in removal of the ceiling on the wage base subject to the payroll tax for employers; three, raising the taxable wage base for employees in four steps of $600 each above the automatic rise in the taxable wage base; four, shifting a portion of the HI rate to OASDI beginning in 1978; five, raising the contribution rate for the self-employed to its intended level of 1½ times the employee rate; six, instituting a symmetric eligibility test for dependents' benefits, and seven, moving up the tax rate increase of one percent each on employers and employees scheduled for the year 2011, ¼ percent each to be implemented in 1985 and the remainder in 1990.

The proposal which addresses the long range deficit concerns correcting an unintended technical error in the cost of living adjustment formula which involved "decoupling" the benefit calculation at the time of retirement from the postretirement cost-of-living benefit adjustment. The administration has proposed a wage indexed mechanism for the calculation of benefits at the time of retirement which would stabilize replacement rates. This is among the most important proposals which this committee has been asked to consider, and one which the National Council of Senior Citizens most strongly endorses.

Decoupling: There is no disagreement over the fact that the technical error must be corrected. Under the present formulation, replacement rates—that is, the proportion of previous earnings replaced—may rise over time if price increases dominate wage increases, and they may decline over time if wage increases dominate price increases. Clearly, replacement rates should be a function of deliberate policy and not an accident of outside forces.

However, decoupling the system requires that an explicit policy decision be made regarding the long-term level of replacement rates. If retirees are to maintain not only the purchasing power of the benefits, but also share in rising productivity over time and thus maintain their relative position in the income distribution, then the adjustment should be made on the basis of increases in wage rates. If the system were to be indexed solely on the basis of price increases, as recommended in the Hsaio report, the replacement rates would decline because of the progressive nature of the benefit structure, and even under conditions of constant purchasing power, retirees would be relatively worse off than they are today. Since a person's well-being is intimately connected with his economic status relative to others, the National Council strongly favors the wage indexing approach as represented in the bill offered by a distinguished member of this committee, Senator Bentsen.

Moreover, those who support the recommendations of the Hsaio report are jeopardizing a primary goal of social insurance: Adequacy in maintaining not only a minimum level of subsistence but more importantly adequacy in maintaining a customary standard of living achieved during one's working life. Although, for many the program falls short of this ideal, further deliberalization by instituting declining replacement rates is inimical to the best interests of society. First, it would do violence to the program meant to address the problems associated with loss of income; second, it would shift the burden of society as a whole to the dependent population itself; third, the working individual would be justifiably uncertain of what level of adequacy in retirement was obligated to him; and fourth, as a result, the political acceptability of the payroll tax at current levels would be jeopardized.

Again, I would like to reiterate several points made earlier: The changing demographic structure of our population indicates that the social security system will be even more important in future years, not less important; all the problems of society at large need not be resolved solely in the context of the social security system. Deliberalization of the benefit structure violates both of these principles.

We, therefore, strongly urge that Congress not overreact to anticipated demographic changes by attempting to address this difficulty and the independent problem of correction of the technical error by the same policy prescription. Attempts to serve two goals by one policy instrument may only ill-serve both. We, therefore, respectfully urge that the Congress support the decoupling proposal as set forth by the Carter administration.

Another administration proposal, and one which appears to have generated much controversy, is the recommendation to infuse countercyclical general revenues into the trust funds in the amount lost when unemployment exceeds 6 percent for the period 1975 through 1978,

effective as of 1978 through 1982. Among the concerns voiced, two appear to be paramount. The first argument claims that the entitlement principle will be eroded, while the second argument is usually put in terms of a question: Where are we going to get the money? Both concerns deserve careful answers.

In regard to the entitlement principle, which I, too, want to preserve, looking at the experience of other Western industrial nations is helpful. The social security system of other industrial nations are far older than ours, and the debate over financing alternatives in the light of economic and demographic changes which is now so prominent in the United States, occurred much earlier in most other countries. This may wound our pride in our foresight; yet, it is fair testimony to how quickly we must get on with the business of restoring the financial integrity of our system.

Although the payroll tax is by far the most important means of financing in all industrial nations, every country—with the single exception of France—uses general revenue in some form to finance their social security systems. Some use a specific percentage formula, some infuse a specific lump sum, and in at least three cases—Austria, Holland, and Canada—deficit financing analogous to the administration's proposal is used. General revenues account for roughly 15 to 20 percent of program expenditures in almost all other countries, regardless of the manner in which it is infused. In absolutely none of these cases has the entitlement principle been endangered.

From a more positive perspective, there is every reason to actively support the use of general revenues as a part of the system. In order to more fully understand the philosophical basis for the use of general revenues, I ask your permission to disgress for a moment on the principles of social insurance.

Back in 1938, Reinhard A. Hohaus, one of the chief architects of our social security system and former vice president and chief actuary of the Metropolitan Life Insurance Co., commented on the essential tradeoff that is the essence of the system. He indicated that there is an inevitable contest between the twin objectives of adequacy and equity. The social security system has traditionally struck a balance between the two. Therefore, the purists who advocate the dominance of equity in the system will be left unsatisfied. Similarly, the purists who demand complete social adequacy may also criticize the system, since it can never completely meet that goal. But both sets of critics fail to recognize that if it completely met either goal at the expense of the other, it would be a far less useful instrument.

In his classic statement in 1938, Reinhard A. Hohaus spelled out these issues with the incisiveness and clarity that can be a guide to us now, almost four decades later, and I quote:

> Social insurance is molded to society's need for a minimum of protection against one or more of a limited number of recognized social hazards—such as dependency. The payments for minimum protection must be met in one form or another anyway, and social insurance endeavors to organize the budgeting therefor and dispensing thereof through systematic governmental processes. Hence, just as considerations of equity of benefits form a natural and vital part of operating private insurance, so should considerations of adequacy of benefits control the pattern of social insurance.

The foregoing need not necessarily imply that all considerations of equity should be discarded from a social insurance plan; rather, the point is that, of the two principles, adequacy is the more essential and less dispensable.

Thus, the social security system represents a balance between two goals: One, social security adequacy and two, individual equity. Contributions into the system support three elements consistent with the overall goals:

1. Future security for self and spouse when retirement is likely to occur;
2. Future security for self, spouse, and other dependents should the unfortunate event of disability or premature death of the family breadwinner occur; and
3. Adequate security for less fortunate members of society who have low earnings histories, irregular employment, or become disabled or who die leaving dependents.

There appears to be no justifiable reason why anyone should be excused from supporting the third element. And, our most progressive form of taxation—the income tax, which is the basis of general revenues—is the fairest way to support the interests of society as a whole.

In addition, a moment's reflection may be sufficient to convince anyone that the payroll tax relieves general revenues of the "welfare" burden that it would otherwise be called upon to support. Why, then, cannot general revenues be called upon when the payroll tax has reached its socially desirable limit? What is sauce for the goose is sauce for the gander.

The second reservation mentioned previously was the concern over where we were going to get the money—general revenues, in this case. Yet, this is the usual question confronted by every program. If the elderly, the disabled, and their dependents or survivors were not lifted out of poverty by social security, where would the money come from to sustain them? Certainly, we would not turn our backs on them. Therefore, the "where would we get the money" criticism merely begs the issue.

The case for general revenues—even on a permanent basis—is clear to the National Council of Senior Citizens. The case for general revenues was recognized in the law from 1944–1950 when language existed authorizing general revenues on an as-needed basis. Yet, the President's proposal is far more modest. It requires only sufficient general revenues on a one-time basis to make up for the loss of contributions to the trust funds only from 1975 through 1978. The cautious and flexible nature of the general revenue proposal should offend no one.

Removing the ceiling on the wage base subject to the payroll tax for employers.

Another proposal of the administration involves phasing in removal of the ceiling on the wage base subject to the payroll tax for employers. Not surprisingly, the business community has voiced loud objections to this approach. Yet I am surprised that I did not hear similar objections when the previous administration offered a proposal to raise the tax rate on all covered wages. It seems to me that businessmen, in this case, are not aware of what is in their own best

interest. The administration has been careful to point out that this approach actually costs employers less than conventional social security financing would cost. At the present time, the full wages of 85 percent of workers in covered employment is subject to the payroll tax; only 15 percent of the covered work force would impose an extra payroll tax liability on employers. And I am told by the Social Security Administration that there is no evidence that these higher wages are heavily concentrated in certain sectors. This means that the extra payroll tax liability would be shared and will have far less financial impact on individual businesses than the alternatives of an across-the-board tax rate increase, as proposed by the previous administration.

Again, the experience of other industrial nations may serve as a guide. Many foreign systems have covered shares paid with the employers contributing a larger share than employees. This does not represent a basis departure from social insurance principles since there is no magic in an equal division of costs.

To the social security system itself, this approach has many advantages. It does not impose any further future liabilities on the system and it avoids regressive taxation of lower- and middle-income workers.

This proposal, in particular, is indicative of the care the administration has taken to assure that: One, no sector of the economy and no individual will be unduly impacted by the financing needs of the system and two, to move in the direction of more progressive financing.

Other proposals: The remainder of the proposals—phasing in modest increases in the taxable wage base for employees; raising the contribution rate for the self-employed; shifting a modest amount of the HI rate to OASDI: moving up the tax rate increase scheduled in the law for the year 2011; and refining the eligibility test for dependents' benefits so that men and women are treated equally—all operate in a conventional manner and improve the financing and equity of the system. Certainly, there should be no controversy attached to any of these proposals.

In summary, the administration's mix of proposals represents a balanced approach with full consideration of the alternatives before us. Additionally, they are appropriately timed, both to meet the needs of the system and to avoid an adverse impact on the economy. Moreover, the proposals operate within the existing benefit structure; they are philosophically consistent with the nature and intent of the program; they are equitable, and they are appropriately cautious and flexible.

Mr. Chairman, I would like to impart to this committee the words of one of your own eminent colleagues, Senator Hubert H. Humphrey, in addressing our group a few weeks ago, and I quote:

> A society may be judged by how it treates three groups of its population: Those in the dawn of life, its young; those in the twilight of life, its elderly; and those in the shadows of life, its disabled.

Thus, the decisions made today may be the basis on which our society is judged tomorrow.

I thank you.

Senator NELSON. Thank you very much.

Do I understand, then, that the National Council of Senior Citizens endorses each specific proposal in the administration's plan?

Mr. CRUIKSHANK. Yes, sir.

Senator LONG. I would like to ask a question of Mr. Cruikshank. First, let me say that I have a high regard for you. I have admired you for a great number of years. I think probably all of us on this committee hold you in very high regard, Mr. Cruikshank, for the fine work you have done in the social security welfare area for a great number of years.

Did your hair turn white in this cause or did you start out with white hair? The first time I saw you you had white hair.

Mr. CRUIKSHANK. I turned white at a very early age. I was getting white when I came into this. So none of my gray or white hairs can be attributed to sessions before this committee, Mr. Chairman.

Senator LONG. Well, you have picked up some wrinkles and wear in the course of all of this.

Mr. CRUIKSHANK. Yes, and thank you for your generous comments.

Senator LONG. I am very much concerned about the security and solvency of this program, just as you are. You make the statement that the income tax is the fairest way to pay, and I have bought that philosophy down through the years. But I want to look at our government as a whole at the moment.

We have two big taxes to rely upon now, the income tax and the social security tax. The income tax was here first and that was the one that was covering the burden of general government prior to the time we had the social security tax.

Now in carrying the burdens of general government, the income tax and all of the rest of the taxes put together are not doing the job. They are leaving us about $60 billion short. And we have other suggestions being made of things that should be done in government, some of which I am sure you strongly support, such as health insurance, which are going to increase the cost of government by a great deal more than we can economize anywhere. If anyone thinks you are going to finance these programs by economizing on something else, he is deceiving himself to the point he should be ashamed of himself. It will cost money to do those things over and above what we are raising now.

The President is going to bring down his tax reform suggestions and try to make the tax law more reasonable. In some respects, the income tax is counterproductive. In some respects, it tends to defeat its own purpose. I believe that we are going to find that the President is going to say that when he recommends tax reform.

I don't know what he is going to recommend, but everything I am hearing from people in the business world, from people in the Treasury, and from the enterprising newspaper people around here is that the President is going to recommend reducing the 70 percent top tax rate and eliminating a lot of the so-called shelters or tax advantages that one group or another has. That will give us a more uniform tax system.

But if he does what he says he is going to do and tax income only one time so as to provide a credit for corporate income taxes against

personal income taxes—however he works it out, he will not be sending us a tax reform bill which will bring us a substantial amount of money.

I predict that it will be a revenue loser. That being the case, the income tax is not going to cover the burden of general government. It is going to be about $60 billion short, even if the economy does pick up.

I don't see a prospect of more employment coming. As a matter of fact, the things that we do to gain full employment are going to cost us a great deal of what we will make when we do get people more fully employed.

That, then, gets us to our third big source of revenue. Right now, with this government running a $60 billion deficit, we would be broke if it were not for the fact that the Federal Reserve is annually printing $60 billion of greenbacks over to the Treasury. If that were the only way we were financing the social security program or general government, you and I both know that as fast as they print more money, the value of our money would depreciate.

In other words, if we were trying to finance our government with printing press money, if we doubled our money supply, by the time we got through printing 100 percent more money, the money would purchase half of what it did before, with the result that we would meet ourselves coming back—like trying to lift yourself off the ground by your bootstraps. Wouldn't that be the case?

Mr. Cruikshank. Yes, but there are many other considerations. Of course, as chairman of the Senate Finance Committee, you have wrestled and continue to wrestle with the whole problem of the broad tax structure of the United States and its people. We start with the postulate, however, that the people of this country are not going to desert its elderly people, its disabled people, and its orphaned children. And we approach the same problem that you do and share the same concern, but we approach it from another direction, of course. We take this postulate, which I am sure you share, that this country is not going to desert these people. The problem we are confronted with is the whole social cost. That is, even if we did not have a social security system, the social cost would be with us still, and it would fall unevenly and haphazardly upon the children who have to support their parents and grandparents and all.

We have devised a better structure of distributing that burden.

So the Government mechanism is a mechanism for more evenly distributing that burden. Now it becomes, then, since we will have this cost, it becomes a matter of how we are going to distribute it, how we are going to use the machinery of Government to provide a more equitable basis for distribution. And now that the whole social security system is in the consolidated budget, it does become a matter of its being in competition with every other program.

But the question of where is the money going to come from is one that confronts every one of your programs with which you are concerned.

The same question is applied to our defense. It is applied to our educational programs as well. So that it becomes a matter of priorities. And we are confident that the Congress, led by your committee and Chairman Ullman's committee in the House, are going to give

a high priority to the needs of the elderly and to sustaining the soundness of the system.

We know the money does not grow on bushes. We know that you cannot just cavalierly create it and run printing press money without running into the other dangers which you mentioned. But we only ask that with the compassionate approach to the problems of these people, that this be given a high priority as you devise ways of using Government to meet what is a social cost and will confront us anyway.

Senator LONG. I am sure you know, Mr. Cruikshank, and you have probably explained to others what I will say at this point, that about half of the trouble we have with people in this world could be resolved if people would just spend a little more time putting themselves in the other person's shoes for a few moments and analyzing the other person's problem, rather than insisting upon looking at it from their point of view.

Let me ask you to look at this problem from my point of view for a moment.

If I go out on the Senate floor to ask someone to pay a tax to finance the foreign aid program, they will vote me down. All I will do is the charge of the light brigade. About one-third of the Senate won't even vote for the foreign aid appropriation right now.

Suppose you try to get the Senate to vote for a tax to finance foreign aid. One-third of the Senators will say, I am against the whole fool thing to begin with and I won't vote to pay 1 penny for that. But the rest of them would find great difficulty explaining to people that they voted for this tax.

Now if we can find the votes and make the Senate and the House vote for anything, we ought to be able to make them vote for money to pay for the social security program, because there is a large constituency and a compassionate case. A large number of the beneficiaries would be in bad circumstances without this social security program.

From my point of view, everything you say is correct, and that being the case, we ought to be able to persuade the Senate and the House of Representatives to vote for whatever tax it takes.

But if we give those fellows the alternative in financing this program by printing press money, I feel that they will take it. When you add that to all these other programs for which it is much more difficult to persuade the Senators and Representatives to vote, I fear for the fiscal solvency of this country.

Now, if the money is no good, it doesn't make a lot of difference that we are willing to levy enough taxes to pay for the program that you are here to advocate. The fact that the whole government is basically unsound will undermine your program along with everyone else's program.

That is why I think that when you have a program such as the social security program, which we can finance with taxes, if we tell those people in the Senate and the House, either you vote for this tax or these people are not going to get those benefits, that we can finance them. There may be some difficulty, but there is no doubt about the outcome. We will raise the money.

But if we are going to turn to the printing press for the social security program, which, from my point of view, is the easiest of them all to finance for the simple reason that if that Congress if faced with a bill that contains both the benefit and the tax, when you get down to final passage, those men are going to vote for that bill.

I am concerned about trying to finance this government with printing press money to any greater extent than we do already. That is why I hope that you will join some of us and say, let's put on whatever taxes it takes to pay for this program, because we can do it. The only thing that will keep us from doing it is defection in our ranks, with the alluring appeal, for example, of trying to finance this program with printing press money.

If you are going to take that approach, all we are really doing is covering the deficit in the social security program by increasing the deficit in the general government. That approach might very well lead to complete fiscal insolvency of the whole government over a period of time.

I am for the program. I believe enough in the social security program to vote for whatever taxes it takes to pay for it. I just hope we can get you to advocate the tax it takes to pay for it. We will be needing your help.

Mr. CRUIKSHANK. We feel that we are advocating the tax that it takes to pay for it. If you mean an increase in the tax rate, we feel that that has now reached the level where it has an adverse effect on the economy and compounds our difficulties. If we could reduce the unemployment to the modest rate of 5 percent, and hold inflation down to 4 percent in the next four years, that would make a $49 difference in the social security trust fund.

Now all we are proposing is that we have a stand-by provision in the use of general revenues to make up the deficit if we fail to do that. And it seems to me that this is a kind of modest underwriting approach to the whole social insurance system.

Senator LONG. It seems to me that you have not thought of the overall fiscal problems to the extent I would like you to think about them.

We are not anywhere near paying for the expense of general government with the taxes that we have, other than social security tax.

That being the case, rather than have a social security program leaning on the same taxes which are not adequate to pay for the general government the way it stands now, the social security taxes should be used to finance the social security program until we can find, if we ever do, whatever it takes to finance general government otherwise.

Now you say the income tax is fair. I agree with you on that. But when the income tax advances to the point that it becomes counter-productive, and a further increase in the tax just results in less revenue rather than more, at that point I think we should all agree and we ought to turn to some other source of revenue, even though it might be a less progressive source.

Mr. CRUIKSHANK. I am sure that you recognize, sir, that it is taxing the same population. Now it is a different distribution within

the population, to be sure, but by some limited reliance on general revenues, we are asking that the population of the United States, to have supported more out of the pockets of the well-to-do and less out of the pockets of the low income people. And if you would lump all of these taxes together, if you would combine them into one single tax approach, you would still want to have it so graduated that it would hit the lower income people with less impact than it would the high income people, I am sure.

So we do not have it all lumped together. We do not have a single tax. Therefore, we look upon the combination of the tax structures to achieve the same end. And we think the President's proposals meet that criterion.

Senator LONG. Well, the President, I believe, has your confidence, as one who shares your tax philosophy.

Is that correct, sir?

Mr. CRUIKSHANK. I would hope so. I have not discussed this in detail with him.

Senator LONG. Knowing what you know about him at this moment, I would hope that you would think so.

Mr. CRUIKSHANK. Yes; I do.

Senator LONG. My guess is he is going to recommend to us a tax bill which he feels puts as much burden on the relatively few in this country who are wealthy compared to those who are not wealthy, as he believes can be achieved without being counter-productive.

I think he is going to do it that way and I would like to ask you if that is about what you are anticipating. Because I think if the President sends his tax reform bill down to us this year, he will be recommending to us a mix of tax increases and tax cuts and tightening up on so-called tax loopholes or totally eliminating certain tax shelters, to the extent that he will be bringing out a bill which he believes will tax those few who are wealthy up to the point that to go any further would be counter-productive.

That's what I think he is trying to do.

Mr. CRUIKSHANK. He may well be.

Senator LONG. That is the way I judge it.

If we do that with the income tax, and I think we will, I think that is a judgment the Congress will make, if each man votes the way his intelligence makes him see it. We will still be left with this big deficit to continue with and that means that we are going to have to pay for these other things.

Once you have taxed the affluent up to the point of diminishing returns, it seems to me that from that point forward, when you are talking about the blue collar workers or these very skilled workers that some of them may be, and the good wages that some of them are receiving on down to the lower end of the middle income bracket, that is where you are going to have to raise most of your tax money because there is where the numbers are.

In other words, you have so many more of those taxpayers than you have who are very affluent. So most of your additional income will come from them of necessity, because there is nowhere else to turn for it, once you have taxed the affluent to the extent that you think that you should.

Now as far as those people are concerned, what difference does it make to the average working man with whom you are very familiar, that he pays as a tax increase by way of a consumer tax or whether he pays as a tax increase by way of a payroll tax or by way of an income tax? What real difference does it make to him if it is the same amount of dollars he is paying, in any event?

Mr. Cruikshank. If it is the same amount of dollars, it probably doesn't make any difference, but it will not be the same amount of dollars for large blocks of the population, for large groups of the work force.

It is true, of course, what you say, that there is a point of diminishing returns in taxing the wealthy. But there is also a point of diminishing returns of taxing the low income people and you can have, perhaps, a more adverse effect on the economy by taxing the low income people than you can by taxing the high income people.

Senator Long. But if a tax fails on all consumers, it is generally regarded as a regressive tax, and in many respects, the social security tax does. You and I agree with that, I am sure.

Mr. Cruikshank. The tax, taken in itself, is regressive, yes, sir.

Senator Long. It is passed on to the consumer as a hidden sales tax and to the extent that it does, it is generally regarded as a regressive tax.

But do you agree with me that there are things that we can do so that a tax which starts out being regressive can be tailored or put into a combination of taxes with others so that the sum total is not regressive?

For example, some years ago I went to Senator Nelson, who is the chairman of this subcommittee, and said, why don't we put a provision in here that says if you don't make enough money to give us an income tax, we will give you back the money that you paid in social security taxes. From that hopeful beginning eventually emerged the earned income credit. For the low income people who have children to support, we are giving them back what amounts to 10 points of the social security tax. There is no reason why we cannot extend that. I think you would approve of that principle.

Mr. Cruikshank. I think that was a sound approach and we hope that it can be continued and extended to all of those in the low-income group, not just those with dependent children.

Senator Long. That, I think, has merit, but I also think it has a lot of merit to extend it to provide more than a $400 credit. I would like to see it be perhaps twice that much.

But in any event, we agree on the principle.

When we say we will use a refundable income tax credit to give you back either all or part of what you paid by a tax that falls heavily on the poor, then that reduces or relieves the criticism that the tax tends to be regressive.

There is one other point involved here when you talk about a tax which tends to be regressive in nature, for example the social security tax or a value-added tax, which I have been upbraided recently by the Washington Post for mentioning in one of these hearings. If a poor man is paying it, he is paying it on a fairly small amount of income or a fairly small amount of consumer expenditures. The more affluent person is paying it on a much greater amount.

The fellow on the lower end pays a smaller social security tax and he gets a tax break to help offset even part of that. And then, when you look at the benefit side, if he gets five times the benefit which he pays in taxes, if you look at the sum total effect, the social security system is not really a bad deal, it is?

Mr. CRUIKSHANK. No. We think the system, taken as a whole, is not regressive, when you add the benefit side to it to counter-balance the effect of the regressive tax. The tax alone is regressive. Yes, the social security system, as a whole, I don't think, can be characterized as regressive.

Senator LONG. You know, my uncle, who was the governor of Louisiana on more occasions than one, campaigned once for office on the basis that he was going to guarantee at least a $30 welfare payment to aged people. This was in the 1950s at that time. And at that time it was a pretty good amount of income, especially compared with other States. And when it came time to try to find out who would pay for it, he said he was going to advocate a sales tax to do it.

He said now, admittedly, that will fall on the poor. They will have to pay that along with everybody else, but they are going to get all of that money back. They will get every nickle they paid plus what the other fellow pays.

The sum total effect is that for the low income, the low- to middle-income people, they are getting back about $5 in benefits for what they pay out in taxes, even though some of that benefit is paid later on in life.

Can one really complain if the government is, in effect, trading him $5 bills for $1 bills?

Mr. CRUIKSHANK. No, they can't on that deal, of course. Senator, I think it is fair to say, and true, that there are probably a number of combinations of tax proposals, both in the broad tax approach that you have mentioned that you anticipate having a chance to review from the President, and combining them with the social security taxes.

We feel that the President's proposal is a well thought out one which does reflect the combinations which meet the criteria of fairness and equity and the proper distribution of the load of caring for the elderly, the disabled, and the orphans in our society.

That does not mean that we, in the National Council, or I, personally, would have a closed mind to other proposals. If there are sources of revenue that meet the criterion of fairness and equity and also the redistributive objectives of a system of this kind, certainly we would be willing to sit down with you, your colleagues, or anyone, to help review those to see if they fit in.

We just feel that a good bit of thought has gone into this already. This is a program that meets these criteria. We are not saying it is absolutely the only one or that we would not consider any other. We would surely be willing to work with you, your Committee, and their staff, if you are considering alternatives to meet the same broad objectives.

Senator LONG. The only one I find to cause serious concern is the recommendation which amounts to financing this program with printing press money. I think this program has always been financed.

Actually, the original actuarial assumptions were such that in the earlier years, we were taxing more money than we were paying out in benefits. I am not sure it was all that good an idea but we did, and that was a decision made back when you were there and long before I got here.

But it seems to me that as a minimum, when we move away from building up reserves, at least we ought to have the courage, and I say this as an elected official, to go back and face the public and ask people to vote for us, having voted for those taxes. We ought to have the courage to go in there and ask the Senate to vote for whatever taxes it's going to take to pay for these benefits—not for the Federal Reserve to print more money, but to put the additional taxes on and see to it that year by year we raise at least as much in money as we pay out in benefits, and we ought to raise somewhat more.

I have no apologies for voting for social security taxes. I think that the program is worth it and we ought to be willing to face up to it.

Now as I say, if I can't persuade a Senator to vote for taxes to pay for the social security system, I couldn't persuade him to vote for anything, in my opinion.

I think we can sell it and I think we ought to insist on raising the money in taxes to pay for this program.

Mr. CRUIKSHANK. I assure you that your estimates of your powers of persuasion are not below ours. We have a very high estimate of your powers of persuasion.

Senator LONG. We will try to keep this government fiscally sound.

Thank you, and thank you very much, Mr. Chairman, for letting me trespass on your time to the extent that I have. I didn't hear the bell ring and I thought it was going to ring any moment.

Senator NELSON. As chairman of the full committee, you are excused.

[General laughter.]

Senator NELSON. Excuse me.

Senator DANFORTH. I will make up for it by asking no questions at all.

Senator NELSON. Thank you very much. It was very nice to have you here.

Mr. CRUIKSHANK. Thank you for the opportunity of appearing before you.

Senator NELSON. Our next witness is Mr. William Dennis, appearing on behalf of the National Federation of Independent Business.

STATEMENT OF WILLIAM J. DENNIS, JR., DIRECTOR, LEGISLATIVE PLANNING AND RESEARCH, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. DENNIS. Mr. McKevitt, our General Counsel, regrets he cannot make it today. He has been detained on some business in California.

Mr. Chairman, NFIB, on behalf of its 510.000 member firms, appreciates the opportunity to present the views of small business on President Carter's social security financing proposals. Social Secu-

rity is, of course, enormously important to small business as 56 percent of the private nonfarm work force is employed by small firms.

NFIB and small business has a vested interest in maintaining a viable social security program as small businessmen and their employees will utilize social security in varying degrees as a part of their retirement incomes. But, social security taxes are a cost of labor and part of the overall costs of doing business. Increased fixed business costs are particularly critical to small business as many are faced with serious cash flow problems and their ability to pass on increased fixed costs is severely restricted. And social security is not the only Government-decreed cost of business we face. Minimum wage is currently being discussed in the House as are energy taxes. and while national health insurance has only been postponed, it is likely to return.

Small business doesn't care for the administration's social security financing proposals. While NFIB recognizes that larger firms proportionately bear a greater burden from these proposals than we, and that worse possible solutions to the current financial dilemma for us exist, the Carter proposals are generally harmful to small business as much for what they do not do as for what they do do.

The proposals continue to raise payroll taxes. Even though many small firms will feel minimal impact, many will feel a rather substantial one. The point you must bear in mind, however, is that a $100 or even a $1,000—depending on firm size—government-mandated, fixed-cost increase probably will not in and of itself kill any small firm. But it is this $100 or $1,000 increase repeated ad infinitum that is driving small business to the wall.

Perhaps worse, the administration's proposals unnecessarily perpetuate major inequities small business currently encounters in the social security financing structure. We all recognize the social security system is a massive intergenerational—and intragenerational for that matter—income transfer program. NFIB does not challenge the social goal of providing low-income retirees with some type of subsidized income. But small business does strenuously object to having employers, particularly small employers, regardless of income, pay 50 percent of the bill for this subsidy.

NFIB would, therefore, offer the outline of an alternative proposal.

We suggest the existing OASI program be divided in two. For lack of better terminology, we will refer to the two resulting programs as part A and part B.

Part A would resemble an insurance program. It would be financed by employer-employee contributions just as the existing system. But the benefit structure of part A differs from the existing system in that the existing subsidy would be stripped away, and benefits accrue to individual contributors regardless of household status or earnings.

In other words, part A involves two primary conceptual changes from the existing program. The beneficiary becomes the individual rather than the unit. The benefit becomes the employer-employee contributions plus interest rather than the existing "mish-mash" of need and contributions criteria.

The part B program assumes there will be a number of elderly receiving part A benefits in such sums that will not permit them

and/or their families to exist at reasonable standards. Part B, therefore, is a program patterned directly after the existing supplemental security income program.

Part B focuses on family need. Benefits are determined by subtracting family income from some arbitrary standard. Thus, part B beneficiaries would receive two checks, their part A entitlement based on their employment contributions and their part B benefit based on their family need.

Since part B benefits are social subsidies and not earned entitlements, they would be financed from the general revenues subject to annual appropriation.

There are a number of advantages in moving to such a system. We list 10 of them beginning on page 13 of our full statement, not the least of which are a reduction in OASI payroll taxes, rationalization of the benefit structure and a decrease in long-term obligations.

Regrettably, NFIB does not see the principles used to develop our OASI proposal as being applicable to the disability insurance and hospital insurance programs. Small business recognizes that a tax rate—or wage base—increase whether for OASI or Hospital Insurance, makes no practical difference for the small employer and his employees. And we are disturbed by the upward trend in total costs for the DI and HI programs. Nevertheless, NFIB cannot provide any reasonable conceptual alternative to these two programs at this time.

Mr. Chairman, NFIB, on behalf of small business, has attempted to provide you with the reasons we believe make the administration's proposals unsatisfactory, and to present you a constructive, reasonable alternative to at least a major part of the problem. We appreciate the opportunity to do so.

Senator NELSON. The full and detailed statement of the National Federation of Independent Business will be printed in the record, as well as your summary statement.

I did not have a chance to read the detailed statement, but did you make computations as to where your proposal would lead the social security fund over the projected period and what kind of tax would be left, if any?

Mr. DENNIS. We did some preliminary cost estimation, but we did not put cost figures into the testimony at all. Quite frankly, because they are so rough, and we need full actuarial work done on the proposal.

In general, we see a reduction of total outlays. In effect, if the system, or concept—and I must emphasize we are talking about a concept—the reason we are presenting it at this time is because we are strongly of the feeling that we need to begin thinking in new directions rather than merely tinkering with the existing system. But if the concept were in place now, total outlays would be reduced by the subsidy cut to wealthy people. That saving would be countered, to some degree, by the intragenerational subsidy that currently exists.

Depending upon how high you set that arbitrary standard for the part B, we think at this time you would have no greater outlays. Over the long run, obligations would be reduced because your employer-employee OASI tax would be reduced. Therefore, his total contribution, on which at some subsequent date he will receive a part A benefit will be reduced.

Senator NELSON. You would include in your so-called part B, which would be funded, I take it, from the general fund.

Mr. DENNIS. Yes, sir.

Senator NELSON. And then part A would be simply an insurance plan which would pay an entitlement of whatever it was to contributions, employer-employee, at retirement.

Mr. DENNIS. Yes, sir.

Senator NELSON. What is the list of items you include which would be funded under the general fund, then?

Mr. DENNIS. I was referring simply to the OASI fund. Is this your question, when you ask what items?

Senator NELSON. What items would you cover out of the general fund for part B of your program? What concept?

Mr. DENNIS. The concept of need. It is based on concept of need by family units, somewhat similar to the current existing SSI program.

Senator NELSON. That is already funded through general revenue.

Mr. DENNIS. Yes, exactly. I am sorry I am having trouble with the question you are asking.

Are you saying how much in dollar terms are we talking about? It is about half. The subsidy is about half right now.

In the existing OASI program, about one-half of all dollars paid out to beneficiaries are subsidies in the sense that they are not related to their contribution, their employer's contribution, plus interest.

Senator NELSON. You say it is subsidized, but it is not coming from the general fund.

Mr. DENNIS. Not now, no. Under the proposal, which would currently approximate one-half of the OASI fund, part A benefits would be determined by contributions plus interest. The remainder of that, the subsidy, which is the other half of the fund, would then be, under the proposal, drawn from general revenue.

Senator NELSON. What items are subsidized now? If you are talking about the subsidized items, what are they?

Mr. DENNIS. When each person draws a benefit, that is in some degree a subsidy because it is more than what he has contributed, his employer has contributed, plus interest. Some are being subsidized more than others.

Let me give you one example of a type of person who is being subsidized more than another: A married person and his wife. The wife has not contributed at all to the system.

If you contrast that, let's say——

Senator NELSON. At that point, you would require the general fund to pick up that part of the subsidy.

Is that what you are saying?

Mr. DENNIS. That is correct.

What you do is determine how much he had paid into the fund. He would then receive his part A benefit. If his part A benefit plus any outside earnings, income through dividends, et cetera, is not sufficient to reach some standard, some arbitrary standard, then you would have to go to the general revenues for a part B supplement.

Senator NELSON. I see what you are saying. All right.

Mr. Long?

Senator LONG. Thank you very much.

I think there is a lot of merit to your suggestion, but I would like to know a little bit more about your part B.

Would you mind explaining how your part B would work?

Mr. DENNIS. Yes, sir. When a person retires, he would be deriving some part A benefit and perhaps a private plan. Maybe he has some interest earnings or something of that nature. His total income would be determined. If it were above a certain standard, whatever that standard happened to be, then he would receive a supplement in part B income, which would be drawn from general revenues of the Treasury.

Senator LONG. Thank you very much.

Senator NELSON. Thank you.

[The prepared statement of Mr. McKevitt follows. Oral testimony continues on p. 206.]

STATEMENT OF JAMES D. "MIKE" MCKEVITT, WASHINGTON COUNSEL, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Chairman, NFIB on behalf of its 510,000 member firms appreciates the opportunity to present the views of small business on President Carter's Social Security financing proposals. Social Security is, of course, enormously important to small business as 56 percent of the private non-farm work force is employed by small firms. In fact, if forced to choose issues which have sustained active membership interest over the past decade, Social Security would easily rank among the top three.[1]

At the outset, we think it vital to outline certain characteristics of small businesses that are not well recognized. Individually small business is indeed small. but in aggregate small business is big business—by far the nation's largest business. There are approximately 3.7 million employers in the nation of which over 95 percent are small. These firms produce 43 percent of the private, nonfarm GNP. But, NFIB's median member, which reflects the small business community as a whole, annually grosses about $300,000-$350,000 and employs 6 to 9 people (full-time and part-time employees). Ninety-five percent of our membership employs 40 or fewer people, making the size distribution of NFIB tilt slightly toward smaller and medium sized small business.

If not totally absent, hard data on small business is usually weak. But NFIB would like to present a few facts that influence us and that we hope will be helpful to you in your deliberations.

Small business is more labor and less capital intensive than big business. The Small Business Administration estimates it takes an average investment of $7.250 to create one job in a small firm:[2] the Department of Commerce has estimated investment costs as high as $30,000 for larger firms.

Payroll as a percentage of gross varies enormously from type of business to type of business. Construction tends to be the highest with approximately 25 percent and wholesaling the lowest with approximately 7 percent.[3] The retail trade which constitutes the largest small business sector is about 10 percent.

Wages paid by small firms tend to be generally lower than in large firms. NFIB data indicates that approximately 50 percent of the persons employed (full-time and part-time) by small business, exclusive of the construction, agriculture, and manufacturing sectors, are paid less than $3.00 per hour.[4]

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[1] The other two are OSHA and paperwork.

[2] Letter from Andrew A. Canellas, Acting Assistant Administrator, Small Business Administration to James D. McKevitt, Washington Counsel, National Federation of Independent Business, March 8, 1977.

[3] For Proprietorships of between $200,000 and $500,000 annual gross receipts. Internal Revenue Service, *Statistics of Income—1972, Business Income Tax Returns*, (U.S. Government Printing Office: Washington, D.C.), 1976.

[4] Dunkelberg, William C., NFIB Statement on H.R. 3744, Proposed Fair Labor Standards Amendments of 1977, before the Subcommittee on Labor Standards of the House Committee on Education and Labor, March 9, 1977. The statement was based on extrapolations made from data contained in: Dunkelberg, William C., and Bailey, Richard M., *Minimum Wage Legislation and the Independent Business Community*, (NFIB: San Mateo, Cal.), 1973. Also see: "Employee Compensation in the Private Non-Farm Economy, 1972", Bureau of Labor Statistics, (U.S. Government Printing Office: Washington, D.C.), 1975.

Regrettably, we have great difficulty providing you data estimating the number of persons employed by small business earning $16,000 (the Social Security wage base) or more. All evidence indicates it is a relatively small percentage, at least in comparison to larger firms. But there will be considerable variation by industry sector, regional, and urban-rural factors.[5]

The relatively low wage levels shouldn't be surprising in light of the fact that self-employed workers (small business proprietorships) have *lower* median earnings than do wage and salary employees, even though these proprietors put in long hours and frequently use unpaid family labor.[6] But the range of self-employed worker earnings is greater as many do quite well and others fare rather badly. To some degree, the Census statistics on which these statements are based, are deceptive. A large number of small businessmen are incorporated, thereby, technically classifying these entrepreneurs as employees. Since larger small firms tend to be incorporated, it is NFIB's judgment that small entrepreneurs' earnings (understanding they include payback on the original investment) are somewhat higher than wage and salary employees when this segment of entrepreneur is included.[7] As a result, the typical small businessman, judged by income, falls squarely in the middle class.

When reviewing President Carter's Social Security financing proposals, NFIB kept several factors in mind:

First, small businessmen and their employees will utilize Social Security in varying degrees as a part of their retirement income. Therefore, NFIB has a strong interest in maintaining a viable Social Security program;

Second, Social Security taxes are a cost of labor and part of the overall cost of doing business. Increased fixed business costs are particularly critical to small business as many are faced with serious flow problems and their ability to pass on increased fixed costs is severely restricted;

Third, do these proposals end Social Security tax increases or are they merely another step in seemingly endless increases? Small business cannot continue being "nickle and dimed" to death;

Fourth, Social Security is not the only government decreed cost of business increase we face. Minimum wage is currently being discussed in the House as are energy taxes, and while National Health Insurance has only been postponed, it is likely to return;

Fifth, paperwork is an enormous problem for small business. The Senate Small Business Committee has estimated a small entrepreneur will spend one day per week filling out government generated forms;

Sixth, the family, generally a wife, often spends considerable time working for the firm as unpaid labor. As a practical matter, they receive no wages, thereby, avoiding Social Security taxes. This arrangement is prevalent because spouses cannot draw their own benefits anyway. We find the phenomenon is most frequent in the smallest business and those having difficulty;

Seventh, small business believes in equity. Small business should neither pay a disproportionately large share of any program nor should it pay a disproportionately small one; and

Finally, NFIB not only considers itself the protector of existing small business, but also of the opportunity to become a small entrepreneur. Therefore, proposals adversely impacting entry into the business community concern us.

Applying these considerations to President Carter's Social Security financing proposals, NFIB finds them generally wanting. Only on the first—financial viability of the program—does the President's proposals meet small business tests and that is precisely the point on which we are least qualified to speak.

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[5] If it is assumed supervisory and managerial employees and no one else earn the wage base or more (shaky assumptions at best), NFIB membership profile data indicates 41 percent have no employees earning the wage base, 30 percent have one, 20 percent have two to four, 5 percent have five to eight, and the remainder have nine or more. On a sector by sector basis, however, matters change dramatically with the median small manufacturer having approximately one of four employers in some supervisory or managerial capacity.

[6] For a more detailed discussion on "self-employed" workers, see: Ray, Robert N., "A Report on Self-Employed Americans in 1973", *Monthly Labor Review*, (U.S. Department of Labor: Washington, D.C.), January, 1975.

[7] The *NFIB Quarterly Economic Report for Small Business*, (eds.) Dunkelberg, William C., and Bailey, Richard M., (NFIB: San Mateo, Cal.), series, clearly demonstrates the better financial position of larger small firms vis-a-vis smaller small firms. But after-tax earnings per dollar of sales for manufacturing corporations are approximately twice as much for large manufacturers as small ones. See: Federal Trade Commission, *Quarterly Financial Report for Manufacturing, Mining and Trade Corporations*, series.

There is no doubt in our minds that the package will increase revenues and reduce obligations, thereby, bringing to the Fund(s) some degree of financial integrity. But we are not here as actuaries and must reasonably defer those judgments to others.

On virtually every other account, however, the proposals fail small business needs. While NFIB recognizes that larger firms will proportionately bear a greater burden from these proposals than we, and that worse possible solutions to the current financial dilemma for us exist, the Carter proposals are generally harmful to small business as much for what they do not do as for what they do do. Let me share some of our specific concerns:

The Administration proposals to continue to raise payroll taxes. While the amount of increase will vary considerably from firm to firm, removal of the wage base from the employer's contribution would affect a very rough 15 to 20 percent of small firm employees.[8] The provision would generally leave the smaller proprietors untouched. With a $30,000-$35,000 payroll spread among four full-time employees and one part-time employee, there are proportionally few instances where a single employee will be earning more than the wage base.

As the size of firms grow, matters do change. Small manufacturers, for example, which tend to pay higher wages as well as employ more people per firm than small retailers, will be affected by the abolition of the wage base for employer contributions—some rather seriously. The same would be true of small wholesalers although to a lesser extent as the frequency of skilled labor employed is less. But construction, transportation, and professional services, largely irrespective of firm size, will feel an impact.

The typical small firm will feel the greatest impact from the tax rate increase. The one-half of 1 percent increase in the nondeductible self-employment tax, and the scheduled .20 percent rate hike as well as the accelerated .25 percent proposal will affect every firm. While the dollar increase per se may seem relatively small for the individual firm,[9] it must be viewed in historical perspective and in light of other government mandated fixed cost increases.[10]

The point you must bear in mind is that a $100 or even a $1,000 (depending on firm size) government mandated fixed cost increase probably will not in and of itself kill any small firm or forbid entry of new firms. But it is this $100 or $1,000 increase repeated ad infinitum that is driving small business to the wall. This trend simply cannot be sustained. But here we see the President's Social Security proposals doing precisely that.

Supposedly these financing proposals will rectify the short-term and long-term financial problems of Social Security. However, NFIB has this nagging suspicion we will be forced to come back again in the near future, because even if passage of these proposals patch the financing mechanism, we see a bulge growing in the benefit structure.

Perhaps, we rely too heavily on experience in making this assessment. But we see serious questions of beneficiary equity which will have to be addressed. NFIB itself has raised one—the wife who is in fact a partner in the business and cannot draw benefits. Unquestionably, each of your offices has received voluminous correspondence on the problem of the earnings limitation imposed on working senior citizens. Even President Carter, at the time this testimony

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[8] As mentioned earlier in the testimony, NFIB has an enormously difficult time estimating the number of small business employees earning the wage base or more. The "15 percent to 20 percent" estimate is given only to present the Subcommittee with some "ball park" figure, and is clearly not meant to be definitive.

The estimate was derived by taking the 19 million employees estimated by the Social Security Administration to be earning $16,500 or more and subtracting approximately 10 percent employed by State and local governments. Comparative "pay for time worked" ratios were then developed for firms employing less than 100, 100 to 499, and 500 or more, from BLS figures. The number of persons employed by firm size was then taken from Census data. Since firms under 100 employees employed roughly half the private work force, but paid a 20 percent lower average compensation, it was estimated that approximately 6.8 million employees would be affected. Dividing that figure into the total number of persons employed by these firms yields the very rough estimate.

[9] Assume a small firm with a $40,000 payroll and the proprietor earning $16,500. His existing total Social Security bill is $3,495—the equivalent of 20 percent of the proprietor's income. Other factors remaining constant, the increased bill would be $162.50.

[10] Between 1970 and 1980, the Social Security wage base will have risen from $7,800 to $20,700 and the tax rate from 4.8 percent to 6.05 percent for the employer. The wage base will have doubled for both State and Federal Unemployment Compensation programs with the estimated average tax rate for both moving from 1.74 percent to 3.45 percent. The minimum wage was $1.60 in 1974 and will rise to heaven only knows what in 1980.

was in preparation, indicated he would appoint a blue-ribbon panel to review Federal retirement benefits.[11]

So, when that bulge is patched in the benefit structure, we must also apply another patch on the resulting financing bulge. Will small business then return with the same assessment of the new financing proposals that we now offer on President Carter's financing proposals—"Yes, it will adversely impact us; no, it will not kill us in and of itself."—or will small business then return with the assessment—"This is the straw that breaks the camel's back?"

Perhaps worse, the Administration's proposals unnecessarily perpetuate major inequities small business currently encounters in the Social Security financing structure. We all recognize the Social Security system is a massive inter-generational (and intra-generational for that matter) income transfer program. In fact, two of every three dollars paid out in retirement benefits (1970) are *not* the contribution of the beneficiary and his employer (plus interest).[12] Those two dollars are a direct cash transfer program from the working generations to the retired generation.[13]

NFIB does not challenge the social goal of providing low-income retirees with some type of subsidized income. That is another question. But small business does strenuously object to having employers, particularly small employers, regardless of income, pay 50 percent of the bill for this subsidy.

Let's take an example: Mr. Jones, an employer earns $20,000 from his business; his payroll is $35,000, all of which is subject to Social Security tax. Mr. Jones, therefore, annually pays $1,732.50 into OASDI on behalf of his employees, and a non-deductible $1,155 on his own behalf. Mr. Smith, an employee, also earns $20,000. His payment into OASDI is $816.75. That means employer Jones, with the same income as employee Smith, pays $2,070.75 more. Assuming two-thirds of these dollars are directed to subsidizing current retirees, Mr. Jones is paying $1,387.40 more in subsidy.[14]

NFIB simply cannot rationalize this condition. Nor, for example, can we rationalize governmental employees not helping pay the subsidy. But the Administration's proposals perpetuate these unjust conditions and make them worse by placing an even greater burden on small business. So, small business is not only being told to shoulder a greater amount of the subsidy load, but shoulder a load that is inequitable in the first place.

NFIB does not wish to criticize the Carter administration too severely. Social Security problems are not of its making and it was forced by circumstance into immediate action. Our complaint lies with an unimaginative response and a failure to utilize this enormous opportunity to review the entire Social Security program.

Having told you small business is not happy with the Carter Administration proposals, we feel it incumbent upon us to offer you a reasonable and responsible alternative. While the proposal remains a skeleton, we feel it offers significant promise in resolving the financing problem as well as many questions of beneficiary equity. NFIB does not offer this as the only acceptable approach to small business, but as one moving the discussing in new positive directions.

The following are the assumptions upon which the NFIB proposal is based:

NFIB assumes the Social Security Trust Fund is in financial difficulty, and the gap between revenues and obligations will continue to grow without significant change in the existing system;

NFIB assumes payroll taxes, of which Social Security is the largest, adversely affects employment and are a cost of doing business;[15]

NFIB assumes it is not socially wise nor politically feasible to reduce benefits of present retirees;

NFIB assumes employer-employee contributions are an essential ingredient of a Federal retirement insurance program; and

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[11] After inquiries to the White House and HEW, it is not yet clear whether or not Social Security will be among those retirement benefits.

[12] Munro, Douglas R., "Welfare Component and Labor Supply Effects of OASDHI Retirement Benefits," (Ph.D. dissertation, Ohio State University: Columbus, Ohio), 1976.

[13] The ratio of subsidy to contribution should shortly be approximately 1:1.

[14] The subsidy is slightly inflated because the OASDI rather than the OASI tax was used in the calculation.

[15] See "Economic Recovery and the Financing of Social Insurance", Staff of the Senate Budget Committee, (U.S. Government Printing Office: Washington, D.C.), 1977.

NFIB assumes Federal social programs in contrast to insurance programs, should be financed progressively via the graduated income tax.

NFIB proposes the existing OASI program be divided in two.[16] For lack of better terminology, we will refer to the two resulting programs as Part A and Part B.

Part A would resemble an insurance program. It would be financed by employer-employee contributions just as the existing system. But the benefit structure of Part A differs from the existing system in that the existing subsidy would be stripped away, and benefits accrue to individual contributors regardless of household status or earnings.

In other words, Part A involves two primary conceptual changes from the existing program. The beneficiary becomes the individual rather than the unit. The benefit becomes the employer-employee contributions plus interest rather than the existing "mish-mash" of need and contributions criteria.

The Part B program assumes there will be a number of elderly receiving Part A benefits in such sums that will not permit them and/or their families to exist at reasonable standards. Part B, therefore, is a program patterned directly after the existing Supplemental Security Income (SSI) program.

Part B focuses on family need. Benefits are determined by subtracting family income from some arbitrary standard. Thus, Part B beneficiaries would receive two checks, their Part A entitlement based on their employment contributions and their Part B benefit based on their family need.

Since Part B benefits are social subsidies and not earned entitlements, they would be financed from the general revenues subject to annual appropriation.

There are a number of advantages in moving to such a system:

First, we make the system rational and comprehensible. Very few persons including those receiving Social Security benefits have even a minimal understanding of how the existing system operates. Beyond paying Social Security taxes, drawing Social Security benefits, and having a Social Security number, the program remains a mystery. There is simply no good reason for unnecessarily perpetuating such complexity in an open democratic society.

Second, the proposal allows us to address specific problems without creating distortions in other parts of the program. For example, if it were determined under the current program that the minimum benefit needed to be raised, then the system might be further distorted by forcing a tax rate increase (regressive) or a wage base hike which eventually raises the maximum benefit and causes long-term obligations to soar. In attempting to raise Social Security revenues, President Carter decided to generally avoid these two distortions, but created a third one, i.e., removal of the wage base for employers only.

Third, the proposal places rationality and equity into the benefit structure from the beneficiaries' perspective. That is not now true. Persons who contribute don't necessarily receive benefits; persons who don't contribute may receive benefits. Some are "docked" for working after retirement, while others having a greater income receive the full benefit. It simply doesn't make any sense.

The proposal eliminates most of those problems. Part A benefits are your contributions plus interest. Part B benefits are more arbitrary, but are generally classified as "need".

Fourth, the proposal forces persons not contributing to Social Security to pay their fair share of the subsidy given low income retirees. Since Part B benefits will be financed from general revenues, no person can escape paying his fair share. The largest group affected will be the approximately two million Federal employees who now contribute virtually nothing to the maintenance of the low-income elderly.

Fifth, the proposal permits utilization of general revenues without violating the general principles of a trust fund.

Sixth, the proposal reduces payroll taxes, thereby, creating employment and halts regressive taxation.

To some degree labor is an elastic commodity. The higher its cost, whether the specific cost be wages, benefits, payroll taxes, etc., the greater the propen-

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[16] As this testimony was in final preparation, an articulate though brief essay was published arriving at the same conclusion as did NFIB. See: Boskin, Michael J., "Social Security: The Alternatives Before Us", *The Crisis in Social Security: Problems and Prospects*, (ed.) Michael J. Boskin, (Institute for Contemporary Studies: San Francisco, Cal.), 1977.

sity to substitute for labor. As the staff report of the Senate Budget Committee pointed out, "The existing system of employer payroll taxation creates a number of anti-job biases."[17]

The current Social Security financing structure is regressive in that it compels lower income people to pay a considerably higher proportion of their income to support a social subsidy program than do higher income people. In fact, a substantial number of Americans now pay more in Social Security taxes than income taxes. The proposal effectively changes that condition by financing the subsidy (Part B) through general revenues.

Seventh, employer-employee contributions would still be made to create an earned entitlement. The employee would, therefore, draw a Part A benefit that is his by right and not by the gratuity of Uncle Sam. It also ensures that every employee is compelled to some extent to make a contribution to his own retirement. While one of the criticisms of this proposal will be that it serves as a disincentive to saving for retirement, the proposal certainly is far more reasonable in that regard than drawing totally from general revenues.

Eighth, the increasing coverage and reliance on private pension plans should in the long term relax the cost of Part B. In other words, the growing number of workers which would be entitled to both Part A and private pension benefits would over a period substantially reduce the number of persons qualifying under Part B. That reduces public expense and public involvement in the retirement system.

Ninth, at some point in time (we assume a transition) relatively poor workers, whether employees or employers, would stop helping subsidize wealthy retirees.[18] All retirees receive a subsidy under the existing benefit structure whether it is needed or not. That situation would not occur under this proposal because those not in need would receive only the Part A benefit.

Lastly, the proposal will restore lessening confidence in a successful and still popular program. The success of Social Security has been founded in the public's willingness to finance it. But increasingly younger workers are questioning the proportionately large amount they are paying and wondering whether anything will be left when they retire. This is not a healthy sign.

By alleviating the regressive taxation and rationalizing the benefit structure, the proposal helps bolster long-term public support for the program.

Despite overwhelming advantages, this proposal is not without defects. It has liabilities and we believe it only fair to discuss at least some of them:

A practical problem.—there must be some transition period (at least on the benefit side) so that persons can plan their retirement. This is of particular concern to persons nearing retirement age. While to many beneficiaries there will be no problem in switching to the new program immediately, it would prove difficult for many of those receiving a private pension as well as Part A benefits. For example, John Doe plans to retire at age 65 in 1980. He counts on receiving $400 a month from his Social Security and $400 a month from his private pension for a total of $800 per month. Under the proposal, however, the Part A benefit would only be about $200. Therefore, he would only total $600 per month. (It is assumed $600 per month is too much to qualify for Part B benefits.) As a result, some phase-in period is crucial.

Strengthened private pension plans.—since relatively high income beneficiaries over a period of time would have their Federal benefit relatively reduced to their true entitlement, pressure would be added to strengthen existing private plans and institute new ones.[19] Such a development would have far reaching

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[17] "Economic Recovery and the Financing of Social Insurance", *op. cit.*, p. 5.

[18] Total family money income in 1974 where heads of household were 65 and over was as follows:

Income:	*Percent of families*
$4,999 or less	28.3
$5,000 to $9,999	38.4
$10,000 to $14,999	17.3
$15,000 or more	16.0

Source: U.S. Bureau of the Census, Current Population Reports, series P-60, No. 101, "Money Income in 1974 of Families and Persons in the United States" (U.S. Government Printing Office: Washington, D.C.), 1976.

[19] For a discussion of small business and private pension plans, see: Fielding, Bruce G., NFIB statement on S. 901, "Pension Simplification Act", before the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Committee on Finance, May 24, 1977.

ramifications that we are not totally able to assess. Positively, it moves the private sector into a relatively greater role in the provision of retirement income, which should also mean greater availability of investment capital. Negatively, it means greater influence over the capital markets by pension fund trustees.

Disincentive to save and provide pension plans.—it can be argued that the low income which now have difficulty saving would have absolutely no incentive to do so under the proposal. This would be particularly true if this individual did not qualify for some private plan. In other words, since he knows Part B will take care of him anyway, why save any of his already limited funds?

Similarly, why should an employer establish a modest pension program when he recognizes Part B will take care of his employees anyway?

There will unquestionably be persons taking advantage of the situation, but then isn't that the situation now? Further, we would not expect Part B to provide princely sums to beneficiaries and we further anticipate some consideration of positive personal savings and private benefits would be considered in Part B calculations.

Administration.—any subsidy program has administrative problems and Part B should be no different. Questions and determination of need are not always easy to tackle, particularly when large numbers of persons are involved. But there would exist one major practical difference between administering Part B and a conventional subsidy program. That is, the income of the elderly tends to be fixed and subject to fewer fluctuations than a conventional welfare recipient. Persons are also less mobile. This eases administration of Part B considerably. And while it will always remain a problem, it may not prove as difficult as many might expect.

Only one program.—the proposal directly addresses only one, albeit by far the largest, of the Social Security funds. But there is no intrinsic reason why the OASI program cannot be reformed in the manner suggested without a simultaneous conceptual change in the other programs.

Regrettably, NFIB does not see the principles used to develop our OASI proposal as being applicable to the Disability Insurance and Hospital Insurance programs. These programs are conceptually as well as practically based on the principles of "shared risk". Therefore, while there may be an intergenerational subsidy to pay the "premiums", to distinguish who belongs to what and which revenue drawer should account for what part of the premiums, becomes a mess in practice if not in theory.

Small business recognizes that a tax rate (or wage base) increase whether for OASI or Hospital Insurance, makes no practical difference for the small employer and his employees. And we are disturbed by the upward trend in total costs for the DI and HI programs. Nevertheless, NFIB cannot provide any reasonable conceptual alternative to these two programs at this time.

Mr. Chairman, NFIB, on behalf of small business has attempted to provide you with the reasons we believe make the Administration's proposals unsatisfactory, and to present you a constructive, reasonable alternative to at least a major part of the problem. We appreciate the opportunity to do so.

Senator NELSON. The hearing will resume tomorrow morning at 10.

[Whereupon, at 12:10 p.m., the hearing was recessed, to reconvene on Friday morning, June 24, 1977, at 10 a.m.]

SOCIAL SECURITY FINANCING PROPOSALS

FRIDAY, JUNE 24, 1977

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met pursuant to notice at 10:05 a.m. in room 2221, Dirksen Senate Office Building, Hon. Gaylord Nelson (chairman of the subcommittee) presiding.

Present: Senators Long, Nelson, Curtis, Packwood and Danforth.

Senator NELSON. Today the Senate Finance Subcommittee on Social Security holds its fourth day of hearings on proposals to solve the immediate and long-term financing problems of the social security system.

The subcommittee has thus far received testimony from the Secretary of Health, Education, and Welfare, Joseph Califano, from a panel of experts which included a former Secretary of Health, Education, and Welfare and a former Social Security Commissioner, from several organizations representing labor, small businesses, and older citizens.

The subcommittee today welcomes William Hsiao, Associate Professor of economics, Harvard University, and Chairman, Consultant Panel on Social Security, which wrote a report for the Congressional Research Service on future financing of the social security system; Robert Myers, former Chief Actuary for the social security system and currently a consultant on social security and professor of actuarial science at Temple University; and Otto Eckstein, professor of economics, Harvard University, a former member of the Council of Economic Advisors, and head of Data Resources, Inc.

I understand that both Mr. Hsiao and Mr. Myers will appear together, followed by Prof. Otto Eckstein.

Mr. Hsiao, Mr. Myers, your statements will be printed in full in the record. You may present them however you desire.

STATEMENT OF WILLIAM HSIAO, ASSOCIATE PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. HSIAO. Mr. Chairman, I am pleased to have this opportunity to appear before you this morning as you consider the best way to restore the financial soundness of the social security program.

During the 1975–76 period I have chaired a Consultant Panel on Social Security appointed at the request of the Senate Finance Committee and House Committee on Ways and Means, and this panel consisted of a group of actuaries and economists; and let me make

clear that none of us has even run for the office of sheriff, but we did manage to get one actuary who is retired and who is receiving social security benefits.

We spent 1 year studying various alternatives in an attempt to solve the financing problems of social security, and this panel has made a written report to the Senate Finance Committee.

My testimony today presents the major recommendations made by this panel.

I realize this is the fourth public hearing you are conducting on this subject. I will not be redundant to repeat again the problems confronted by the social security program, rather I will just make a very brief summary of what they are.

I think everyone knows the social security program is incurring serious financial deficit right now and it will continue for the future.

In fiscal year 1978 the program is estimated to pay out $95.2 billion.

Senator NELSON. What year?

Mr. HSIAO. Fiscal year 1978, and it is expected to have a total income of $89.1 billion, thus incurring a deficit of $6.1 billion.

The financial deficit in the short run largely resulted from three factors: The recent rapid rate of inflation, the increase in unemployment and the technical error in the automatic adjustment provision in the benefit formula.

The most serious long range problem confronted by the social security program is the double indexing of the benefits. I would like to go into that in greater detail later. The double indexing problem is further exacerbated by the demographic bulge. We have recently seen a swing from a baby boom to a baby slump, and this will increase the number of retirees while reducing the number of workers at the beginning of the 21st century.

Today there are 30 beneficiaries per 100 workers. In another 25 years we expect there will be 50 beneficiaries per 100 workers, so there is more than a 50-percent increase in the number of beneficiaries under the social security program to the number of active workers.

Senator NELSON. You say over 50, there will be 50 beneficiaries for every 100 at what date?

Mr. HSIAO. I am sorry, Mr. Chairman, I didn't hear you.

Senator NELSON. You said there would be 50 beneficiaries for every 100 employees at what date?

Mr. HSIAO. At the turn of the century, the year 2005.

Senator NELSON. Included among those beneficiaries are——

Mr. HSIAO. Retirees and their dependents, disabled and widows and dependent children.

There are many ways to restore the financial soundness of social security. Realistically, there is only one broad approach for solving the short-run deficit problem namely, Congress must provide additional revenue for the system. Any consideration of reducing benefits in order to reduce the deficit is undesirable and politically unviable. Additional revenue can be provided in three ways: By raising the taxable wages, by using funds from general revenue or value-added tax or some other form of new tax, or by raising the social security payroll tax rate.

These are essentially the three major alternatives Congress has in dealing with the short-run deficit problem; but in my opinion the more critical issue is how to solve the long-run problems.

Congress needs to deal with both the short-run and the long-run financing because they are intertwined together; also, social security is a long-term program. Whether the benefits promised to the American workers when they retire can be fulfilled depends on what you do now.

Like any pension program, the benefits usually do not become payable until 20 years to 40 years from the date of any legislative change.

In dealing with both the short-run and the long-run financing problems, I am in favor of increasing the wage base to a point at which the entire earnings of approximately 90 percent of the American workers are covered. Translate that into dollar amount it means in 1978 the estimated maximum taxable earnings base will be increased to $20,100 instead of the $17,700 expected under the present law.

Senator CURTIS. Will you give that year again?

Mr. HSIAO. That is the year 1978, January 1, 1978. If this is adopted——

Senator CURTIS. $20,000 even?

Mr. HSIAO. $20,100, Senator Curtis.

Senator CURTIS. Thank you.

Senator NELSON. To cover 90 percent of what?

Mr. HSIAO. Of the total earnings of 90 percent of American workers.

Senator NELSON. And at what level would the tax rate have to be today in order to do that?

Mr. HSIAO. By increasing the wage base you will be able to generate additional revenue to the system, so the tax rate required to finance the system would not be as great as otherwise. The additional revenue you would generate is approximately 4 percent.

Senator NELSON. How much?

Mr. HSIAO. Four percent.

Senator NELSON. You said to increase the wage base to cover 90 percent of the total employee income?

Mr. HSIAO. No, the wage base would cover the entire earnings of 90 percent of American workers.

Senator NELSON. And my question——

Mr. HSIAO. Earnings. That would exclude the unearned income.

Senator NELSON. My question was, today at what level would you have to increase the wage base tax today in order to cover 90 percent?

Mr. HSIAO. 1977?

Senator NELSON. Yes.

Mr. HSIAO. You will have to increase the $19,800.

Senator NELSON. $19,800?

Mr. HSIAO. No. I stand corrected, $18,700 for 1977.

Senator DANFORTH. Are you saying to cover 90 percent of all earnings of American workers or all earnings of 90 percent of American workers?

Mr. HSAIO. I am saying the latter, that is, all earnings of 90 percent of American workers.

Senator DANFORTH. All earnings of 90 percent of American workers?

Mr. HSIAO. Yes, sir.

Senator NELSON. Now you have got me confused. I thought it was to cover 90 percent of the total earnings of all workers. You are saying there is a difference?

Mr. HSIAO. Yes, sir; there is.

Senator NELSON. Which one are you saying?

Mr. HSIAO. I am saying covering the total earnings of 90 percent of all American workers.

Senator NELSON. I follow you. OK, I had it the other way.

Mr. HSIAO. Let me try and untangle the confusion I am creating. Actually it is not an important point, Senator. The difference between the two, which you are trying to clarify, changes the wage base by as much as the wage base by only $300—$600.

Senator NELSON. It is an important point. It is all the more necessary we get it straight because that is the kind of point we make the most about around here.

Mr. HSIAO. I would like to make clear that raising the wage base by itself will not be sufficient to cover the long run deficit in the social security program. Regardless, what you do about the taxable wage base, if you do nothing to change the benefit formula, even if you take the limit off completely, you will still not be able to finance the social security cash program in the long run.

Many proposals have advocated social security be financed from the general revenue funds. One frequently cited rationale is that a payroll tax is regressive. If the tax is appraised in isolation then it is indeed regressive; but this is taking an exceedingly narrow view of the total social security program.

Under social security, a person's benefits are in part determined by his tax contributions. Both the benefits and the contributions are based on the earnings of the worker. The benefit formula causes a low-income worker to receive benefits that are proportionately higher than those of higher income workers. If the tax and the benefits are examined together, as they should be under the social insurance program, then the whole system in fact is quite progressive.

If general revenue financing is introduced because social security needs additional revenue, I believe we should be mindful that other worthy programs may have more urgent claims on general revenue.

As Senator Long pointed out in his remarks before, we don't have any excess general revenue funds; and even down the road I think there are other programs that may have more urgent claims on the general revenue that will include welfare reform, housing programs, national health insurance, long-term care and a whole series of other economic and social programs that your committee and other committees in Congress are considering.

Furthermore, general revenue financing of social security will weaken the earnings-related nature of the program. It could jeopardize the long-run stability of the entire system, leaving many American workers' expectation of retirement income unfulfilled.

For these reasons I believe it is unwise to use general revenues to financial social security.

Then that leaves the payroll tax or some other form of tax as the revenue sources. Today I would only address the payroll tax.

The amount of additional financing required for the program depends on what method Congress chooses to correct the double indexing problem.

There have been two major proposals advanced before your committee and I realize they are very complicated and they are quite technical, and I think there has been very little debated in the press about the pros and cons of the two major alternatives; nevertheless, both of these proposals have different and serious implications for the degree of control that Congress has on the program and the amount of revenue required to finance the program, particularly to the next generation of workers as well as the equitable treatment among retirees of different ages.

If I may ask for your indulgence, I would like to take a few minutes to explain to you very briefly the two major proposals which had been made in correcting the overindexing problem under the present law.

Both proposals provide for automatic adjustment of benefits according to the Consumer Price Index for those people who are already receiving benefits, so for retirees, survivor and disabled beneficiaries, their benefits would automatically go up with any change in the price level.

However, the two proposals differ in the computation of initial benefits for workers who retire in the future.

The Consultant Panel on Social Security recommends a price indexing method. The way this method will work is to protect the benefits for current workers against inflation as well as in the future.

In addition, the benefits for future retirees will tend to increase because their real wages tend to increase.

Senator LONG. Might I interrupt the witness for a moment?

I am going to have to leave here within the next 20 minutes, otherwise I would be happy to wait my turn. I do want to ask these two witnesses just a few questions.

I would like to ask consent of the committee that I be permitted to ask a few questions at this point, in view of the fact I cannot stay, if my colleagues would be willing to permit that?

Senator NELSON. Do you want a vote on it? [Laughter.]

Senator CURTIS. I have a note handed me they need me on the floor. They want me, I don't know that they need me. If I could ask a couple of questions after he does, I will not object. I won't object anyway.

Senator LONG. Reading these statements I am impressed by both these witnesses. I would like to ask them both about a couple of points. When people talk about taking money out of general revenues, they talk as though the money is coming out of the income tax. My impression is that the income tax is our principal support of our General Government, the national defense, for foreign aid, just whatever. The social security program was always supposed to be financed by the taxes for that particular purpose.

Our General Government is $60 billion in the red. If you are going to try to finance social security by the income tax, all you are

doing is just making the deficit smaller in the social security fund and making it bigger in the general fund. It is purely a matter of borrowing from Peter to pay Paul, with printing press money.

Can you see anything but that type of situation?

Mr. MYERS. I certainly agree 100 percent on what you have just said.

Senator LONG. What is your thought about that, Mr. Hsiao?

Mr. HSIAO. Senator Long, I agree with you but I do want to point out there is a slight different effect in who pays the tax. I want to point out there is that difference.

Senator LONG. That is the point I had in mind.

Looking at it from the point of view of people who are trying to be responsible on a tax-writing committee, if you can't get the members of this committee to muster the political courage to be responsible and try to finance what the Congress is voting to spend money for, then you are not going to be able to get any committee to do that. This committee is accustomed to fiscal responsibility—or at least they are accustomed to hearing about it. [Laughter.]

They are accustomed to talking about it, making noises along that line, even if they are not sincere.

You have got as good a chance of getting this committee to save the country from bankruptcy as you have getting anybody to do so. If we were trying to finance our Government entirely with printing press money, by just financing it out of deficit, am I correct in thinking that as fast as you print more money the value of what you have continues to go down so that you can't run a printing press fast enough to get ahead of yourself.

Mr. MYERS. Once again, I would agree with you completely, Mr. Chairman.

Senator LONG. Do you agree with that, Mr. Hsiao?

Mr. HSIAO. Yes. We see the foreign experience. Germany did that and China did that and they led to hyperinflation.

Senator LONG. We already owe $600 billion plus. If it is a good idea to finance the Government by printing money, let's just repeal all the taxes and then finance the whole cost of government with printing press money. If that is a good idea, why not do more of it? If you did that, if you printed about $400 billion of printing press money, the money you have got in circulation will go down in value by $400 billion at the same time—or maybe more than that because people would lose confidence in the money. Is that correct?

Mr. HSIAO. Yes.

Senator LONG. You both agree?

Mr. MYERS. Yes, sir.

Senator LONG. We have our choice up here. Are we going to go for a bigger deficit, or are we going to raise money to pay for some of these things?

You have to get groups to put pressure on the Congress to get the Congress to do what is in the national interest, but my thought is if you can't get the people to vote for a tax to pay for social security benefits, you can't get them to vote for any tax. If that is the case, the country is doomed to bankruptcy. I don't see any way out.

Do you know of anything that would come nearer attracting the votes of Senators and Members of the House of Representatives than something to pay for the benefits for the aged, the blind, the disabled, the sick, and little children? If you can't get a vote for them, can you tell me anything that has more appeal than that, if you are trying to get votes for taxes?

Mr. MYERS. I can't think of anything that would do so.

Senator LONG. Well, that is the way it seems to me. Therefore, it seems to me that if the President wants to have a balanced budget, the last thing on Earth he ought to do is let these Senators and Congressmen escape their duty to vote for a tax to pay for these social security benefits. I don't think he can get them to vote for a tax to pay for foreign aid. There are all sorts of things he couldn't get them to vote for a tax for. He can get them to vote for a tax for social security, provided they don't have another option.

With regard to the income tax, which is $60 billion in the red, can either one of you gentlemen see how we can cover that $60 billion deficit and find still more to pay for a social security program without taxing beyond the point of diminishing returns?

Mr. MYERS. No, Mr. Chairman.

Mr. HSIAO. I don't have any magic, Senator.

Mr. MYERS. Nor do I, Mr. Chairman.

Senator LONG. Some people say the income tax is fair. If you get the income tax up to where you tax 100 percent of people's income, you will make less money than you do taxing them 50 percent. I believe you agree with that, do you not?

Mr. MYERS. Yes.

Mr. HSIAO. Yes.

Senator LONG. While I can agree we ought to tax the affluent, even tax them right up to the point of diminishing returns, I know what it is to have a tax go so far that it is counterproductive.

I have told this story before, but it might bear repeating at this point. I am reminded of the situation that occurred back in World War II. At least three people sat down to have a few rounds of drinks at the Mayflower Lounge. After a while one of them said, let's go home, hand me the check, I am in the 90-percent tax bracket, it won't cost me but 10 cents on the dollar.

No, let me have it, said the second man, it won't cost me anything, I'm on welfare.

The other fellow said, let me have it, I have a cost-plus contract, I will make a 10-percent profit.

That is the kind of economic waste you are paying for when you tax beyond the point of diminishing returns. Back at that time most of these corporations set up big pension plans for their executives, not for the workers, rather than pay the taxes by the excess profits tax, and they were pouring money down ratholes to find ways to keep from paying the Government taxes during that time. Are you familiar with that fact?

Mr. MYERS. Yes, Mr. Chairman.

Senator LONG. Are you?

Mr. HSIAO. Yes, sir.

Senator LONG. It seems to me while I am satisfied that we ought to tax the affluent as much as we can raise from them, we are going

to have to find other ways to raise money other than that income tax to pay for all these social security benefits.

Now, do both of you agree that that will be necessary, especially if you are going to have health insurance?

Mr. Myers. Yes.

Mr. Hsiao. Yes, sir, I would.

Senator Long. With regard to this point about the social security tax being a regressive tax, it is not true that there are certain other things that should be considered? One of them is this: if you are levying a value added tax or a social security tax, while it is true that it does tax the poor, they are the ones who get the best deal on the taking down end. In other words, a lot of these poor people get $5 back for every dollar they put up. Now, from my point of view, if you want to trade me $5 for $1 bills, I will stay here and trade with you as long as you want to exchange currency. That is point No. 1.

Point No. 2, just because the tax tends to be regressive doesn't mean you can't do something to offset some of the features of the regressivity, as we did with earned income credit. When I started out suggesting this I went to the chairman of the subcommittee, Senator Nelson, and said, I have an idea, why don't we say if a person does not make enough money to owe us an income tax, we will give him back the money he pays in social security taxes, and that is basically the approach of the earned income credit.

Is it not true that when you look first at the benefits that are paid and who gets them and to what degree, and also the fact that you can take a regressive tax and give the money back to the working poor, that there are ways that you can handle a consumer-oriented tax like the social security tax or a value-added tax, in a way where the sum total mix works out where it is a very, very good deal?

Mr. Myers. Yes. I think that you and I have seen this point for years; namely, that you have to look at the entire picture of social security, both the benefits and the taxes. Furthermore, as to regressivity of taxes in general, you have to look at the whole tax picture, not just one part of it.

Senator Long. A gentleman comes up here and testifies from time to time for this organization known as Taxation With Representation, Mr. Brannon, and now and then he gives me a hard time. Sometimes I give him a hard time. But I am always pleased when somebody who gives me a hard time agrees with me on something. He was up here before our committee a few days back saying that when people say the value-added tax is regressive that is just hogwash. He might have used a different word, but it didn't indicate any greater respect for the argument. [Laughter.]

He pointed out the kind of things I am talking about here. He said if you want to, and can do the kind of things we do with the earned income credit, and that is not the end of human imagination, to figure out ways so that low income people are not injured by it.

Once you are taxing the affluent people to a point of diminishing returns, to where you are not going to make any more money by putting more tax on those people—or not enough to make it worth trying to chase the rabbit through the briar patch—after you have

done that, then where you are taxing those middle income people, let's say a worker making $15,000 with a wife and a couple children, it really makes little difference to him whether the tax he is paying is subtracted from the check by withholding on his income or whether it is cranked into the price he pays for the product.

Can you see where it makes a great deal of difference to him which way you do it?

Mr. MYERS. No. I certainly agree with you that any study of tax incidence are a very difficult thing to carry out, particularly if the tax has been in existence for a while. The individual is going to pay it in one way or the other. Very frequently, he just does not realize it.

Senator LONG. One of the most successful taxes we have levied while I have been around here was one that we took a lot of kidding on, a lot of chastisement from the press and others. It was the 8-percent tax on airline tickets. I insisted that we tax everybody, without any exemptions. That stopped the thing of some guy going up, some big shot politician, and he is asked "You are tax exempt?" "Oh, yes, I am tax exempt." He fills out this certificate while everybody else stands in line and waits their turn just cussing to the high heavens under their breath because that guy having helped put the tax on them has exempted himself from it.

We said everybody pays the tax. If you want to give it back to somebody, do it some other way. We also required that the airlines advertise what the final price of that ticket is. If you are going from here to New Orleans instead of advertising $100 and then saying when you are ready to pay the $100 they say, "I am sorry; there is an $8 tax," they put big signs up advertising the fact you paid an extra $8 in addition to the $100. But they still had to tell you the final price.

In due course everybody knew you had to pay a tax to get on the airlines. I don't know of any serious complaint about it. Everybody understands that it is necessary to provide for airline safety and to provide for the runways and the terminals and things of that sort that provide a service.

When you put a tax on and everybody pays it, there is not a lot of complaint about it. Then if you want to give something back to somebody because he is poor or disabled or because he had a misfortune of any sort, you can do that to whatever extent you want to do it. It seems to me from the point of view of the average person, it is probably a little less obnoxious to have it cranked into the price of the product than it is to have him look at that check every week and see whether you have taken this much out of his paycheck.

But in either event I think we will all face up to it; we cannot confer any more benefits on the middle income people by taxing the other guy. There are not that many other guys to tax.

We are getting about 50 percent of their income if they are in the top bracket, and once we tighten up on a few little shelters here and there that we are going to look at in the next year, we will have just about exhausted our potential working those people over.

You might find $1 billion that you might differ with me on, you might think we can pick up here or there, but on the whole, haven't we pretty well exhausted the potential of taxing the affluent for the benefit of the middle income people?

Mr. Myers. I would certainly think so, Mr. Chairman, but I think that you are far more of an authority on that than I am.

Senator Long. Well, if we can have anything left it is all right for me to go after that, I am not complaining about that, but there are not as many people who are getting by without paying their fair share of tax. You might find 1 out of 1,000 or 5 out of 1,000, less than 1 percent, who are getting by in a way that is unconscionable. We are going after them again. We have gone after them twice; we are going back after them again in the tax reform bill that will be up here this year, and pass it next year, and I believe in all fairness if you look at how much we will get by taxing people who have incomes over $50,000, it is not going to be enough to finance any big spending program.

It won't be enough to make a real big dent on the deficit we have to retire. So if you want to provide the social security benefits to these people, it seems to me that we are going to have to put some tax on and we are being deceitful, far less than honest, if we don't tell these rank and file American people that if we are going to balance the budget and provide these additional things that the President of the United States has promised, it is going to cost them a substantial increase in taxes.

Do you gentlemen think that is correct or not?

Mr. Myers. I certainly think that is correct.

Senator Long. Do you?

Mr. Hsiao. Yes, Mr. Chairman. I said in my testimony I don't think we have that kind of money in the general revenue and there would be less general revenue available for other programs which needs that money perhaps more urgently than social security.

Senator Long. Some time back Congress started this principle of saying when we provide for social security benefits we will put the tax in the bill to keep the program solvent, and every time we provide benefits again we will bring the whole program up to the point it is solvent. One can rely upon receiving his benefits out of tax assessed on the American people. I hope we don't depart from that.

It is bad enough to have these horrible deficits in the Federal funds. I would think we should avoid doing the same thing to the social security program.

Do you gentlement agree with that?

Mr. Myers. I certainly do.

Senator Long. Do you?

Mr. Hsiao. Yes, sir.

Senator Long. Thank you very much.

Thank you, Mr. Chairman, for permitting to have my day in court.

Senator Nelson. I was going to say that even though you weren't on the schedule, you have been the best witness we have had thus far. [Laughter.]

Mr. Hsiao, go ahead where you left off.

Mr. Hsiao. There has to be something done to the double indexing of the benefit formula, and I think every expert and student of social security programs agree that has to be corrected. The way to correct it is decoupling. There are two major ways to do this decoupling. They have very serious implications to what extent Congress will

maintain control over this social security program down the road and also how much it will cost to finance each alternative.

President Carter proposed a method of computing the initial retirement benefits by using a wage indexing method. The aim of the wage indexing method is to provide an initial retirement benefit and replace a fixed ratio of a worker's retirement wages.

Under this approach, it is assumed that the standard of living of workers is determined by their present retirement wages. Therefore, the computation for the initial social security benefit should be automatically adjusted to this relative income level of the worker. Meanwhile, the price indexing method when price indexing is measured by the replacement ratio criteria, produces a decline replacement ratio for the future retirees.

These two methods produce very different promises of benefits to workers retiring in the future. The price indexing method guarantees a moderate benefit and preserves a greater degree of control and flexibility for Congress to increase the benefits in the future, while President Carter's proposal would try to make it totally automatic.

In our report, the members of the panel state that we believe an element of flexibility must be built into the social security program. The price indexing method will guarantee a benefit that is protected against inflation and it will allow some financial margin for Congress to use it for either general benefit increases or to deal with unexpected social, economic or demographic changes.

Meanwhile, President Carter's proposal, which uses the wage indexing method, will leave very little financial margin for Congress to make future changes in the social security program. Because of the demographic bulge, the payroll tax rate that requires to finance President Carter's proposal will have to be 19 percent as compared to the existing 9.9 percent.

Senator NELSON. Do you mean that, under the President's proposal as it now stands with wage indexing, the tax would be 19 percent by the year 2000?

Mr. HSIAO. Yes, if there are no other changes to the program. But President Carter also gives you a very complicated package that includes increasing the wage base for the workers as well as for the employers and employees with no maximum limit on the taxable wage base for employers.

Under the complete package proposed by President Carter, the payroll taxes still have to go up as high as about 15 percent or 16 percent at the turn of the century.

Senator NELSON. The tax paid by the employee would be included in that?

Mr. HSIAO. Yes.

Senator NELSON. But you are saying that the President's proposal would have to include some tax base that got to 15 percent by 2000?

Mr. HSIAO. The tax rate is to be 15 percent.

Senator NELSON. The tax rate has to be 15 percent. Since his proposal removes the lid on the tax paid by the employer, there is no place else to get that money other than increasing the tax on the employee, is there, unless you go to the general fund? To get the 15 percent you have to increase the employee tax.

Mr. Hsiao. You would increase the employee's tax but also you increase the tax on the employers because the tax rate applies to both employee and employer.

Senator Nelson. Right.

Mr. Hsiao. This high-level payroll tax rate which is necessary to finance a wage indexing benefit formula is so painful that I don't think everyone including President Carter want to deal with it. The administration proposal made before your committee does not address that issue how to finance the longrun cost of the social security system.

The President proposed to name some kind of outside body or a commission to look into the problem of long-term financing. The simple reason is because the amount of tax required to finance what the President proposes is so high at the turn of the century that it is too painful for anyone to face up to it. Without adequate long-term financing for the program, there is little assurance the retirement benefits expected by the American workers can be fulfilled. The consultant panel does not believe that's an appropriate way to design a long term program.

The essential difference between the wage indexing method and the price indexing method is they guarantee different benefit amounts to people retiring in the future.

The price indexing method promised retirement benefits which are protected against inflation. It leaves the Congress the flexibility to give periodic general benefit increases to everyone.

In contrast to this, the proposal made by President Carter provides a tilt in favor of the workers retiring later on.

The increase in benefits for the current retirees is limited to increases in the rise in the Consumer Price Index, yet workers who retire 5 years later will receive increments due to inflation as well as increases in real wages. This difference can be substantial. Let me just illustrate by example.

For a person who reached age 65 and retired in 1976, the average worker's benefits will be about $350. For somebody who was born 15 years later and retired in the year 1991, that worker's benefit would amount to more than $520 measured in 1976 dollars.

In other words, the person who is retiring 15 years later will get 50 percent more benefits than the one who retired in 1976.

Senator Nelson. In real dollars?

Mr. Hsiao. In real dollars.

Senator Nelson. I thought you stated that President Carter's plan tilted toward an employee working longer? Maybe I misunderstood you. What happens? I thought you were talking about somebody retiring at age 68 instead of 65.

Mr. Hsiao. I am sorry. I did not make that clear. President Carter's proposal tilts toward people who are retiring in the future years. Let's assume they all retire at age 65. It is not what age they choose to retire but rather, because I happen to be born in the year 1911 I am retiring in 1976, I only get $350. If I am born 15 years later, I would get much more. Let me quickly summarize my point.

The recommendation I have outlined here will completely restore the actuarial soundness of the social security program for the short run as well as in the long run. The combination of measures I am

suggesting are first correct the double indexing program by decoupling.

However, price indexing should be used to calculate future benefits instead of the wage indexing benefits proposed by President Carter.

Secondly, raise the maximum taxable earnings base to $20,100 in 1978 instead of $17,700 as expected under present law.

Thirdly, increase the payroll tax rate by 0.3 percent on employers and employees each. This increase in payroll tax rate can be phased in over the next 4 years taking into account our general economic condition.

Senator NELSON. What was that percent, 0.3?

Mr. HSIAO. Point three percent on employee and employer each. The combination of these three measures will completely restore the financial soundness of the social security program. The advantage of this package is it protects social security benefits now and in the future against inflation while keeping the program cost at a reasonable level.

It also preserves the flexibility and control of Congress to improve the program in the future. Furthermore, it gives equitable treatment to the retirees of different ages.

Lastly, of course. it accomplishes the goals that your committee seeks; that is, restore the financial soundness of the social security program for the short run and the long run.

Thank you very much.

STATEMENT OF ROBERT MYERS, PROFESSOR OF ACTUARIAL SCIENCE, TEMPLE UNIVERSITY, AND FORMER CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION

Mr. MYERS. My testimony will be devoted to the financing problems of OASDI and how, in my view, they can best be solved.

What are the problems? Briefly, the short-range financing problem of the OASDI system is that the trust funds will soon run out of money unless legislative action is taken.

The OASI Trust Fund will be exhausted at some time in 1982 to 1984, while the DI Trust Fund will run out of money in 1979, according to the 1977 Trustee's Report. In fact, under these adverse conditions, it is possible that the DI Trust Fund could even be exhausted somewhat before the end of next year.

The long-range financing problem is a little less apparent but is equally serious and significant. The average long-range cost of the program over the next 75 years as shown by the intermediate estimate in the 1977 Trustees' Report is 8.2 percent of taxable payroll in excess of the average tax income. This is a relative cost overrun of 75 percent.

It will be recalled that prior to 1972, any such lack of actuarial balance in excess of 0.1 percent was considered to be unacceptable and thus indicative of the need for prompt remedial action.

Following the 1972 amendments with their automatic adjustment features and thus the need for using dynamic economic assumptions in the actuarial cost estimates, this acceptable margin was increased to 0.50 percent, so at present the imbalance is far in excess of what has been considered to be acceptable.

Quite simply, the short-range problem can be solved either by a reduction in outgo or an increase in income, or a combination of the two. It seems that the most likely solution for the short-range problem would be an increase in the income of the trust funds.

Increased income can be derived from only three sources—higher tax rates, higher taxable earnings bases than those which would otherwise result under the automatic adjustment provisions, and subsidies from the General Treasury; that is, from general revenues or by increasing the budget deficit through borrowing.

Tax increases are, of course, not popular; however, there has been less sentiment against them under OASDI because the general public has in mind its insurance nature.

In my opinion, the approach of increasing tax rates is by far the very best one because it forthrightly and clearly assesses the cost against all participants. The public will thus recognize the financing problems of the program and will share openly and universally in the solution.

At this point I might mention I agree completely with what Chairman Long said in our colloquy this morning. If you believe that the social security taxes are regressive, this can be remedied elsewhere, through other parts of the taxing structure.

At the same time, I believe that the arbitrary ceiling of seven percent for the self-employed rate should be eliminated and that the original basis of 1½ times the employee rate should be restored.

Others have recommended instead that the maximum taxable earnings base should be increased far more than the automatic adjustment provisions would do. This procedure can produce a considerably increased income in the early years, but over the long run it is not very cost effective, because additional long-range benefit liabilities also develop.

I oppose this approach because it is cost deceptive to the general public and because it narrows the scope of the economic security field which can and should be taken care of by the private sector.

The remaining method of solving the short-run financing problem of OASDI is to inject a Government subsidy on a one-time or a continuing basis, possibly to the extent of paying for one-third of the total cost of the program in this way.

I believe that this approach is undesirable because it hides the cost aspects of the program from the public, many of whom would be deceived thereby into believing that somebody else is paying for part of the cost of their social security benefits. Actually, the cost of a Government subsidy to OASDI would be met by virtually the same people who pay OASDI taxes, although the incidence of the taxation might be somewhat different. In fact, it is difficult, if not impossible, to measure the ultimate impact of any tax, even though it is great intellectual sport to attempt to do so.

Specifically, I believe that the short-range financing problem of OASDI should be solved by an immediate increase in both the employer and the employee tax rates of 0.5 percent. This could perhaps be phased in over a 2-year period, such that part of it would come into effect in 1978 and the remainder in 1979.

Such an increase, as this subcommittee knows, is nothing new or unusual. Many such increases have been made in years gone by with-

out serious effects or adverse reactions from the general public. At the same time, the allocation of the tax between the OASI and the DI trust funds would be revised so as to give a somewhat larger proportion to the latter than under present law, in order to remedy its more serious financial situation.

I oppose any transfer of the payroll taxes for the hospital insurance system to OASDI. The 1977 trustees' report shows that HI also has serious financing problems in the next decade. Even if the cost containment proposal of the Carter administration were enacted and were successful, or if other cost control provisions were provided, the HI program would need all the financing through tax-rate increases that would be provided under existing law.

Let us turn to the long-range financing problems of OASDI that remain after the short-range ones are taken care of.

The first and most urgent thing to be done is to restructure the method of computing benefit amounts at initial claim under the automatic adjustment provisions. However, the present procedure for increasing benefits for persons on the roll should be left unchanged because this does operate properly.

As these initial computation procedures will likely operate in the future, relative benefit levels or replacement ratios will steadily rise in the future and, of course, the same thing will happen as to the cost of the program.

Eventually, benefit amounts will reach illogical levels such as being in excess of preretirement take-home pay. Proper structuring of the computation procedures, popularly referred to as decoupling, would eliminate at least half of the longrun actuarial deficit shown in the intermediate cost estimates in the 1977 trustees' report.

The present computation procedure for OASDI benefits is coupled. This has been so not only for the automatic adjustment provisions adopted in 1972 but also in previous legislation that provided ad hoc benefit increases. This procedure worked out well in the 1950's and 1960's, both from a benefit design standpoint and as to the financing results, because, as it so happened, economic conditions then were just right so as to achieve such a result. Under current economic conditions and those that seem likely for the future, this result will not prevail, but rather that the instability referred to previously will occur. This coupled procedure also desirably gives equal treatment to beneficiaries with the same average wage regardless of when they retire.

Under a coupled system, when a percentage increase is given to beneficiaries on the roll, the percentage factors in the formula for primary benefits applicable to new retirees are increased to the same extent.

For example, the formula applicable for June 1975 through May 1976 could be expressed approximately as 46.5 percent of average monthly wage, plus $92. After the 6.4 percent increase for June 1976 for beneficiaries on the roll, the formula became 49.5 percent of average monthly wage, plus $98.

Actually, the exact formula involves some eight steps of average wage bands, and the percentage factor applicable to each of them was increased by 6.4 percent.

Under decoupling, the benefit increases for those on the roll would continue to be made as at present, that is, by the percentage change in the Consumer Price Index; however, benefits for new claimants would be calculated in a different manner than now. The result would be that benefits would not be as sensitive to differing rates of change of prices and wages and, in fact, under some decoupling approaches would not be at all sensitive thereto.

The 1975 Advisory Council on Social Security developed general principles for a decoupling approach which would completely stabilize the relative benefit level. This recommendation was made specific in a bill developed by the Ford administration in 1976, H.R. 14430, and it has also been made by the Carter administration.

In both instances, the ultimate relative benefit level would be at about the same height as it will be under present law just before the new procedure becomes effective.

I strongly support this approach of stabilizing the replacement ratios; however, I believe that such stabilization should occur at a slightly lower level, say, ten percent, so as to recognize the relative overexpansion of the benefit level in the last few years, in part due to the faulty action of the computation procedures.

Under the general approach of decoupling by indexing by wages there would be a new concept of average earnings and a new benefit formula. The previous benefit computation method frozen as of the changeover date would be a transitional minimum guarantee or savings clause for retirees.

The average earnings under the new basis, the average indexed monthly earnings, or AIME, would be determined as at present as to the period of averaging and the number of years to be averaged, but it would be based on wage-indexed earnings rather than actual earnings.

Under the recommendations of the Ford and the Carter administrations, a new benefit formula intended to duplicate closely the results under the present formula as of the changeover date would be used.

Under my proposal, the new formula would produce slightly lower amounts for many cases in the first few years of the changeover. Under these circumstances, however, the aforementioned savings clause would apply and no retirees would get less than under present law, as it would provide as of the changeover date.

The indexing of an individual's earnings for any particular year would merely be his or her actual earnings for that year multiplied by the ratio of (*a*) the average wage in covered employment in the year to which indexing is being done, to (*b*) such average wage for the particular year. The average of the indexed earnings will, of course, be larger than the average of the actual ones.

The revised benefit formula for the wage-indexing method would be a three-step one in the general form x percent of the first \$A of AIME, plus y percent of the next \$B of AIME, plus z percent of the AIME in excess of $\$(x+y)$. The benefit percentages (x, y, and z) would be of a decreasing nature, so as to provide relatively larger benefits for lower paid workers, just as in the formula of present law.

This formula would be changed each year, for new claimants then, by adjusting the dollar bands according to changes in wages in cov-

ered employment. For example, if such wages increase 8 percent from one year to the next, the formula would be changed by multiplying each of the AIME dollar bands by 1.08.

A somewhat different method of decoupling has been proposed by a consultant panel to the Congressional Research Service. Its approach differs from that just described primarily only by having the indexing of the earnings record done with the CPI rather than with average wages in covered employment.

The effect of the panel's approach would be to produce lower AIME's because the CPI has generally risen less rapidly than wages in the past. This difference in AIME concept is compensated for by using generally larger factors in the benefit formula. Such formula initially would, on the average, closely duplicate the results of the benefit formula in present law. The AIME bands would be changed each year by the movement in the CPI.

The apparent—and I stress "apparent" for reasons which I will bring out later—long-range result of the CPI decoupling procedure would, however, likely be to produce decreasing relative benefits or replacement ratios over future years, although benefit amounts would rise in terms of dollars and would maintain the purchasing power of the benefits.

In turn, this would mean that apparently the CPI approach would eliminate a much larger proportion of the presently estimated long-range actuarial deficit than would the wage-indexing approach; but as will be brought out subsequently, this highly desirable result is actually only a mirage because the proposal is of an unstable nature, both logically and politically, and so ad hoc benefit increases would most certainly be made in the future.

The illogical mixture of both price and wage elements in the computation of initial benefit amounts that is present in current law would continue to be present under the CPI-indexing method. On the other hand, the wage-indexing approach maintains consistency by using only earnings elements.

Under the CPI procedure, taking into consideration likely future economic conditions, the replacement ratios would continually decrease over the future unless ad hoc benefit increases were legislated. This decreasing trend seems irrational from a pension planning standpoint.

It would seem difficult, under these circumstances, for private pension plans to supplement OASDI. If the private plan assumed that OASDI benefits would decrease relative to final earnings, it would have the potential danger that such benefits would actually be increased on an ad hoc basis and that then its own benefit level would be too high and thus too costly.

Young persons, particularly, would feel that the CPI procedure is unfair. They could receive relatively lower benefits than the current older generation, despite their paying much higher OASDI taxes, not only in dollars but also as percentages of their earnings.

The advocates of the CPI procedure might claim that Congress will prevent replacement ratios from decreasing in the future through ad hoc legislation, but it is logical to develop a benefit structure that will almost inevitably result in an undesirable situation which must necessarily be changed? Ad hoc legislative patch-

work of an automatic adjustment system could well produce a result as irrational as the present basis.

I believe that OASDI should be automatically adjusted on a basis that will result in relative stability of the benefit level, as the wage-indexing procedure would do. The CPI method attempts to walk on both sides of the street at the same time.

You just cannot have it both ways—dangling the prospect of eliminating the financial problems of OASDI by CPI decoupling before those to whom this will appeal, while at the same time assuring others concerned about benefit adequacy that deterioration will never really occur because there will surely be ad hoc legislative changes in the future.

Returning to the subject of decoupling by wage indexing, some persons might object because it is such a great change from the present procedure and because the concept of indexing is difficult to understand. What other possibilities for the necessary decoupling exist?

Perhaps the first thing that comes to mind is merely to use a final-average-wage approach, such as is successfully done under the civil service retirement system and under many private pension plans. Combined with this, the weighted benefit formula would be adjusted annually by changing the dollar bands accordingly to variations in the general wage level.

Such an approach would not work out well in the nationwide system such as OASDI because of the manipulation, intentional or otherwise, possible by acquiring a high earnings record in the last few years. This could particularly be done by Government employees who are not under OASDI and who take early retirement and then enter covered employment.

Another possible procedure is one that I developed several years ago. It is mentioned in the blue book that your staff has prepared, so I won't go into any detail on that. It would simply use the present method and provide a cap on the increases in the benefit factors, so that they would not increase by more than the lesser of the CPI or 55 percent of what wages increase.

This empirical method would also produce stable replacement ratios.

In balance, I believe that the wage indexing procedure of decoupling, preferably with about a 10 percent lower ultimate level for the replacement ratios, is superior to the procedure just described, of using the present basis modified only so as to have a cap on the relative incrases in the percentage benefit factors that would be based on 55 percent of the increase in the general wage level.

As a solution of the remainder of the long-range problem, if decoupling were accomplished by wage indexing with ultimate replacement ratios being 10 percent lower than those for current claimants, but with a permanent savings clause being applicable so that no retirees will get less than under the present formula as it would be on the changeover date, and if the short-range financing problems were solved by an increase of one-half percentage point in the employer and employee tax rates, it seems likely that the only additional financing needed for at least the next three decades would be

an increase of one-quarter percentage point each sometime in the 1980's. If decoupling is done at present replacement ratio levels, such increase would have to be about one-half percentage point.

In about 30 years, however, a further financing problem would arise under the current estimates as a result of the great changes expected in the demographic situation then.

The solution, I believe, would be to increase the tax rates sizably beginning in about the year 2011, at which time under present law a 1 percent increase in both the employer and employee rates is already scheduled. It is by no means certain at this time how much increase will then be required.

A great deal will depend upon such uncertain elements as future fertility and mortality trends and, equally important, retirement rate trends.

I believe that, after the year 2000 when labor market shortages may show up as a result of current and future low fertility, retirements will tend to be more deferred than the present experience indicates. This can be an important cost-reducing factor for OASDI. As a result, if this occurs, the tax rates estimated to be necessary three decades hence may not need to be as high as now seems to be the case.

Another possibility that has been suggested is along somewhat similar lines; namely, that the minimum retirement age for full benefits should be gradually increased from the present 65 to something like 68, beginning about 30 years from now and phased in over a period of several years. Such proposals now meet with a great lack of enthusiasm from the general public; however, it is conceivable that several decades from now this might well be feasible as contrasted with having higher taxes for OASDI.

Still another factor to be considered is that higher tax rates for OASDI several decades from now may not be too burdensome if at the same time lower taxes are needed for items associated with children, such as public education. Certainly this should eventuate if the demographic situation is such that there are relatively far fewer children in the population than currently.

Next, I should like to discuss the question as to what is the desirable size of the OASI and DI trust funds. Ideally, in my opinion, they should average about 1 year's outgo. They should be somewhat higher than this during good economic times, and then somewhat lower during poor economic times. However, considering what has happened to this relationship in the last few years, which was the result not only of reduced economic activity, but also of inadequate tax rate levels earlier, I do not believe that this relationship can ever be restored in the future.

There is no definite actuarial determination possible of the optimum average size of the trust funds. I would say that we must proceed from where we now are or are likely to be before remedial legislative action occurs. Specifically, I believe that, if certain actions are taken that I will next enumerate, it will be sufficient if the trust fund balance is at the level of about 4 months' outgo.

The administration proposal would justify this level of the trust funds on the basis of providing a Government subsidy in times of high employment, which is labeled as a countercyclical financing

mechanism. I have previously indicated that I oppose this approach for the reason that any Government subsidy to the program is undesirable. Further, I seriously question the validity of the estimated computed amounts of taxes lost because of high unemployment in 1975–78—$14.1 billion.

Instead, there might be considered another approach by which the same ends could be achieved. Such a relatively low trust-fund-balance situation would be satisfactory if the trust funds were granted borrowing authority from the General Treasury. Such loans would be repayable with appropriate interest in specified times of lower unemployment. Interest would be computed in exactly the same manner as is now done in reverse when reimbursement to the OASI trust fund is made by the General Treasury for the special age 72 benefits. The general procedure for loans to the trust funds proposed here is in accordance with what is already being done in the unemployment insurance program.

The proposal of the Carter administration to have so-called countercyclical financing through a Government subsidy is described as producing a "savings" of some $24 billion as a result of a lower trust-fund ratio being suitable. I hardly think that it is proper to call this procedure a "savings." In any event, the same result of a lower trust-fund ratio could safely be achieved in other ways.

One other point, Mr. Chairman. As I mentioned, I read with great interest the excellent blue book your staff prepared.

There was one point there where I had some question about the figures that were supplied, and I would like to ask your permission to include a short memorandum in the record on this point.

Senator NELSON. It will be received in the record.

Mr. MYERS. Thank you.

[The memorandum follows:]

[Memorandum]

SILVER SPRING, MD., *June 22, 1977.*

To: Michael Stern, Staff Director, Committee on Finance, U.S. Senate.

Subject: Possible errors in staff data and materials relating to social security financing.

The above-mentioned committee print, just recently issued, is an excellent compendium of facts and discussion about the subject of Social Security financing. However, I believe that some of the data (which were undoubtedly furnished by the Social Security Administration) contain errors.

Specifically, I am referring to Tables 29–33, which give cost information on various decoupling procedures. The estimated costs as a percentage of payroll generally seem consistent, but this is not the case for the replacement rates.

As to the Carter Administration proposal, the trend of the ratios for the maximum-earnings case is virtually level over the years (from 33 percent in 1979 to 32 percent in 1985 and 1990, and then slightly upward to 34 percent for 2010 and after). All such figures that I have seen previously show a significant upward trend over the years for this category—by about 10 percent relatively (or from 33 percent now to 36 percent ultimately).

As to wage indexing at a reduced replacement rate level, the rates in the early years should be much higher—for 1979, at just about the same level as the Administration proposal. Also, I cannot understand why the ultimate level of the rate for the maximum-earnings case is as high as 33 percent (vs. 34 percent for the Administration proposal). This proposal also involves a much smaller benefit percentage for the highest earnings band, so as to hold the rate down to about 30 percent in the long run.

Finally, as to the procedure of increasing the benefit percentages by the lesser of the CPI or 55 percent of the wage increase, the replacement rates seem too high. I cannot understand how they can start off in 1979 at a higher level (for all wage categories) than the Administration proposal (e.g., 46 percent for the average case, vs. 45 percent). Moreover, I believe that, over the long run, the rates under this proposal will stabilize, but at a somewhat lower level—not at the 1979 level. As a result, I believe that the cost reduction for this proposal will be larger than shown here.

I would very much appreciate your checking back with the Social Security Administration on these points.

ROBERT J. MYERS.

Mr. MYERS. In conclusion, may I express my hope that the Congress will soon take action on remedying the financial problems of the social security system and thereby restore its financial integrity. This is necessary so as to alleviate the fears of the people of our country. Many are deeply concerned that the floor of economic security that they had been planning on will not be there when needed.

Thank you, Mr. Chairman.

Senator NELSON. Mr. Danforth?

Senator DANFORTH. I would like to have the views of each of you on the desirability and the effect of including Federal employees within the social security system with a pension on top of the social security benefits so that the aggregate would not diminish the total amounts that they are receiving now but so that a portion of their coverage would be social security rather than have 100 percent Federal pension.

Mr. MYERS. Senator, I am strongly in favor of coverage of Federal employees and also of State and local government employees as much as can be done. I have held this position for years, and I will first openly admit that I may be said to be in a glass house throwing stones, because I will be getting windfall benefits as a result of having long-term Federal service and only a short time under social security; namely, since I have been a professor; the only offset of that being that perhaps I will not retire at age 65, so the benefits I get possibly would not be payable until age 72.

Such a coordination procedure has been discussed for a long time and has great merit. This was attempted in the days of the Eisenhower administration. I just wish it would be successful at some point in the near future.

Mr. HSIAO. Senator, I endorse that view, and I think universal compulsory coverage in the social security for all workers, regardless of their being Federal employees or State or municipal employees, is desirable and has merit. I also believe that will enhance the workers' ability to plan for retirement as well as the equitable treatment of different workers under different systems.

Senator DANFORTH. Would this improve the financial condition of the social security trust fund?

Mr. HSIAO. I believe it would improve the financial condition of the social security system very slightly.

Senator DANFORTH. Do you agree with that?

Mr. MYERS. Yes; I agree with that.

Senator DANFORTH. Now, I wonder if—I don't want to prolong this, but you have touched, I think, in general on your views of the

administration's program, and what I would like you to do is to very briefly, if you could, alternately go through the administration's proposals and, in a nutshell, like 15 seconds or 30 seconds, tell me your conclusions as to the desirability of the administration's program.

Do you have them there in front of you, in order?

Mr. Myers. I have in mind the eight different proposals of the administration. Two of the proposals involve increasing the earnings base more than the automatic adjustment provisions would do, eliminating it for the employer and raise it by $2,400 for the employee.

Senator Danforth. Let's do this, if you don't mind, so we can go in an orderly basis—why don't I call out the proposal and each of you, in 15 seconds, if you could, respond to it.

One, countercyclical financing out of general revenue.

Mr. Hsiao. I am against any form of general revenue financing at least as designed that way. I think if we want to introduce general revenue financing, it should be through surtax or some approach like that.

Senator Danforth. Through a surtax, because in that way it would be a definable, visible social security tax?

Mr. Hsiao. That is right.

Senator Danforth. Mr. Myers?

Mr. Myers. I am opposed to it both in general, as being against any government subsidy of the system, and I am particularly opposed to the proposal because I don't think the method of determining it is proper, and I don't think it can ever be determined properly.

Senator Danforth. All right. Taxing employers on the entire payroll, removing the base for employers.

Mr. Hsiao. I think that will weaken the equity aspect of the program, the relationship of how much workers contribute and how much benefit they will earn. I believe that will weaken the social security system, and I don't believe that is desirable.

Senator Danforth. I missed that.

Mr. Hsiao. It will weaken the relationship of how much does a worker contribute or contributed by his employer on his behalf and the amount of benefits to be earned by the worker. Therefore, it will weaken the social insurance principle underlying the social security program, and I believe that is undesirable.

Mr. Myers. I am opposed to it, too, on the grounds that I think the equal-sharing concept that has been the tradition over the years is a good one, and it should be retained.

Senator Danforth. Would it tend to drive State and local governments out of the system?

Mr. Myers. It would have that tendency.

Senator Danforth. Would it therefore be self-defeating?

Mr. Myers. There would be a tendency that way.

Mr. Hsiao. Yes.

Senator Danforth. Third, increasing the base for employees in $600 increments over and above the scheduled increases.

Mr. Hsiao. I am in favor of that proposal, as pointed out in my testimony. I believe that is a desirable approach.

Mr. MYERS. I am opposed to it because I believe this narrows the area in which the private sector can provide economic security. Furthermore, over the long run it does not increase the income over the system; it brings in more money in the first few years but creates more benefit liabilities for the future that are just about offsetting.

Senator DANFORTH. Do you think it is absolutely necessary to keep payout to the increases in the base?

Mr. MYERS. Yes; I think that, at least as far as the employee tax is concerned, this is so. It seems to me that you would lose a lot of popular support for the system if taxes were paid on more than you got benefit credit for.

Senator DANFORTH. Four, increasing the tax rate of the self-employed.

Mr. HSIAO. Yes; traditionally, the self-employed tax rate is 150 percent of the employee's and I think that is a desirable feature of the program.

Mr. MYERS Yes; I am in favor of this change, too, although the original 1½ times was an arbitrary figure. I think it should have been retained.

Senator DANFORTH. Five, shifting in funds from the hospital insurance trust fund.

Mr. HSIAO. No; I am against that proposal, as I pointed out earlier. The hospital insurance program is also running a deficit, at least in the intermediate range, I don't think this is a desirable feature, to weaken one part of another program to pay for the cash benefit.

Mr. MYERS. I believe the same way. I don't think you should have all the trust funds going broke at the same time.

Senator DANFORTH. The sixth is decoupling. I will not ask you to take us through that again.

Seven is advancing the planned tax increase from the year 2011 to 1985 and 1990.

Mr. HSIAO. If the Congress adopts the price indexing method, the Congress does not even have to move those tax rates forward, as proposed by President Carter. Under President Carter's proposal, you have to move these tax rates to earlier years is because of how the benefits are determined under the wage index method. They cost a lot more.

Mr. MYERS. I think this is desirable. Since I am in favor of solving the financing problems by a tax raise, I would move the tax rate increase up even more and earlier.

Senator DANFORTH. All right, and the final one is the test for beneficiaries with respect to dependents.

Mr. MYERS. I think that this is a desirable change. I think there is also merit to the other approach recommended by the Advisory Council, of offsetting any dependents or survivors' benefits by any pensions earned under a governmental plan where social security coverage does not exist.

Mr. HSIAO. Yes; I think it is a desirable change, Senator.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator NELSON. Senator Curtis?

Senator CURTIS. I regret I had to leave for a little bit. You have been very helpful witnesses.

I find that in general you are quite in agreement; but Doctor, I want to ask you one thing.

Would you care to comment on Dr. Myers' concern about the price indexing method of decoupling?

Mr. HSIAO. Yes; I would like to comment on that.

I think Mr. Myers' criticism of price indexing is that the replacement ratio would decline and so Congress in the future will have to give ad hoc benefit increases. That is undesirable. I would like to point out, first of all, that the program has been in existence for 40 years, where Congress reviews the program every two or three years and makes any modifications necessary, including giving general benefit increases; and the Congress has acted with responsibility and has built up a stable and successful program.

I don't see why we should lose faith in Congress in the future, its ability to act responsibly and rationally; and secondly, I want to point out under the wage indexing method the benefits are not stable because it gives unequitable treatment between different ages, I mean retirees with different ages, so Congress will still have to correct that problem periodically.

So the criticism which Mr. Myers made on the price indexing method equally applies to the wage-indexing method.

Senator CURTIS. Mr. Myers, is there anything you want to add?

Mr. HSIAO. I would like to point out, it is interesting Mr. Myers does not show what kind of tax rate you, the Congress, has to legislate to finance the wage-indexing method.

Mr. Myers placed a tremendous amount of faith in the uncertainty about the demographic changes or economic changes about the future 30 years from now, and he hopes those conditions might solve the problem; but I think we should be a little cautious in accepting those assumptions.

Mr. MYERS. As you know from my testimony, I can't agree with Dr. Hsiao on this.

I, of course, would not say that the Congress has not acted responsibly in the past and that Congress will not do so in the future, because I know from my long experience that they have, and I am sure that they will. But it is my view that it is irrational to develop a program that is certain to have to be changed, one that you know is going to produce undesirable and unacceptable results.

What counts in this world, I think, is relative terms. People want to retire with benefits that bear some relationship to their recent or final earnings. Under the CPI method these benefits will steadily decrease unless legislative action is taken.

Under the wage-indexing method, which is so widely supported, the benefits will retain their same relative position as they were at the time of enactment. I therefore believe that Congress would want to act in a manner that they think there is a good possibility that the system will operate successfully as enacted and not one that it is known in advance must be changed in some indeterminate manner.

Finally, as to the comment that Mr. Hsiao made about my not being concerned about the long-distance future and only expressing the hope that this might be solved by demographic trends or by retirement age trends, I did have a paragraph in my statement that did take this into account; namely, if all does turn out that the costs are much higher, as they would be under the wage-indexing approach, and I am sure they would be by ad hoc action if the CPI-indexing approach were taken, then higher tax rates would, in my opinion, be necessary and they would not be unbearable even if they reached the level of 16 percent for the combined evployer-employee rate.

Under my proposal they would probably be somewhere between 15 and 16 percent for the employer and employee combined, as compared to the present approximately 10 percent.

I would maintain that such an increase, phased in over the years, would by no means be unbearable, especially considering the very important fact that taxes for children; namely, for public education, will be so much lower in the future if this demographic picture actually comes about.

If you could see the figures of how small the child population would be under these projected demographic trends, which are quite possible, I think you would be very much surprised. We are seeing schools being closed now in a few places. There would be so much less of a cost for child education that this much higher social security tax phased in gradually would really, I am convinced, not disturb people then as it would seem to as we look at it today.

Senator Curtis. My purpose was not to try to resolve it but to clarify it, so this is pursued by our staff as well as members of the committee would understand the context.

I find that the two of you are in very much accord in the general thrust of maintaining the social security fund intact and supported primarily—in fact, entirely—by the payroll tax.

It seems to me that we must consider the feelings and the attitudes and those very deserving aspects of human existence relating to the dignity of the individual, and it has been my observation that the social security system, the retirement system, has been paid with a sense of dignity and sense of participation by the beneficiary and has been a very wholesome thing in that regard, and that we might—I do not know, but we might—endanger it a little bit and have it lean toward a welfare program if we once start to pay it out of general funds.

At least, would you agree that is something we ought to think about and consider?

Mr. Hsiao. Yes, sir.

Mr. Myers. Yes, I would agree.

Senator Curtis. Now another thing—I am glad that the social security benefit formula treats more generously people of low and modest income. I think that is right as a national policy. I favor it.

I believe that the individual better equipped to provide for his own retirement should carry part of the load. Would you both agree that the present benefit formula is geared to give added benefits to those with low and modest income?

Mr. MYERS. Very definitely so, Senator.

Senator CURTIS. That is, does that pertain to retirement in addition to survivors' benefits?

Mr. HSIAO. Yes, sir.

Mr. MYERS. Yes; it relates to all three—retirement, disability, and survivors' benefits.

Senator CURTIS. That is because the formula is so weighted that the greater share of the benefit comes by qualifying, and qualifying for a minor minimum plus a small amount of wage credit; is that right?

Mr. MYERS. Yes.

Mr. HSIAO. Much greater weight is given to the lower income earnings.

Senator CURTIS. As I say—I do not mention this in any way as criticism—I think that a national policy that is a social system should give preferential treatment to those people who must rely upon that solely, and the individual with resources and higher earnings can better be able to add things for his own retirement where many of the people cannot.

I don't want to take the time right now but, Dr. Myers, would you give, for the record, two or three illustrations both in retirement and in reference to survivors, the dollar amounts of some hypothetical cases which will illustrate that for the committee in the printed record?

Mr. MYERS. Yes, sir. I will be glad to do so, Senator.

[The following was subsequently supplied for the record:]

SILVER SPRING, MD., *June 27, 1977.*

Subject: Illustrations of social security benefits for persons at different earnings levels.

The attached table presents data on retirement and survivor benefits under the Social Security program for persons at different earnings levels. In summary, these figures indicate the very considerable heavier weighting of benefits applicable to persons with low earnings.

The retirement case is for a man retiring in January 1977 at age 65, and considers only the primary benefit. An individual who had had low earnings in all years before 1977 (at least as far back as 1956) would have a benefit representing about 57 percent of his final wage. On the other hand, such an individual who had had maximum earnings in all years in the past (at least back until 1956) would have such a ratio of only 32 percent. Thus, the low-paid individual would have a relative benefit almost twice as large as the maximum-earnings case.

The lower part of the table shows survivor benefits for a widowed spouse and two eligible children. If the insured worker dies at age 35, the total family benefits are quite sizable, representing 67 percent of the final earnings for the maximum-earnings case and over 100 percent for the low-earnings case. On the other hand, if the deceased worker was older, these benefit percentages would not have been as high. Thus, for age at death 46 or older, the replacement rate would be about 57 percent for the maximum-earnings case. Thus there is again illustrated the much larger relative benefits for persons with low earnings, although the benefits are quite substantial in all cases.

The anomalous situation as to the extremely high benefits for workers dying at young ages (which would be even more if the age at death that was considered was under 30) has been pointed out at times in the past. It would be eliminated under the proposals that would decouple the benefit computations through the use of the wage-indexing method. Under such circumstances, the benefit results for all ages at death would be somewhat similar to those shown in the attached table for ages at death 46 or older.

ROBERT J. MYERS.

Attachment.

ILLUSTRATIVE SOCIAL SECURITY BENEFITS

Earnings category	Earnings in 1976	Monthly benefit payable	Replacement rate (percent)
Man retiring in January 1977 at age 65, primary benefit only:			
Maximum	$15,300	$412.70	32.4
Average	9,266	335.10	43.6
Low [1]	4,600	218.30	56.9
Person dying in January 1977 at age 35, family benefit for widowed spouse and 2 children:			
Maximum	15,300	856.40	67.2
Average	9,226	711.50	92.5
Low [1]	4,600	416.50	108.7
Person dying in January 1977 at age 46 or older, family benefit for widowed spouse and 2 children:			
Maximum	15,300	722.20	56.6
Average	9,266	168.60	80.5
Low [1]	4,600	328.90	85.8

[1] Assumed at $4,600 in 1976 and following the trend of the average wage in previous years.

Senator CURTIS. Because I believe that many people do not give much thought to the survivors' benefits until tragedy strikes but a young man maybe of 30 years of age having two or three or four children, even though his wages are not exceedingly high, an individual of that age being taken by death, it is a very substantial benefit, is it not?

Mr. MYERS. It most certainly is, and you are quite correct, many people in the general public don't realize the great value of that protection.

Senator CURTIS. So what I would like is two or three hypothetical cases in reference to survivors and in reference to retirement.

As I say, I favor that national policy; I think it is sound, but I also think it is something to consider when we view the overall program and try to work out an element of justice so far as taxing is concerned.

Isn't it also true that at least with some employees who may be regarded as rather modest wage earners in amount, in their later years may move up into the higher brackets and so it is in a sense the same people that are taxed in the higher bracket, in the lower bracket, but through time and experience and promotion they have moved up there; is that correct?

Mr. HSIAO. Yes.

Mr. MYERS. Yes, sir.

Senator CURTIS. Would you refresh my memory concerning the establishment of the Advisory Committee on Social Security to this committee, to the Finance Committee? When did we do this?

Mr. HSIAO. This was done in 1975 in a letter written by Senator Long as chairman of the committee, requesting the Congressional Research Service to appoint a group of outside technical experts to review in detail the financing problems confronted by social security and recommend how to deal with it.

Senator CURTIS. I think it would be interesting to know the origin of it. Senator Long asked the Library of Congress Congressional Research Service to do this?

Mr. HSIAO. Yes.

Senator CURTIS. And how large a commission or group of advisers was appointed?

Mr. Hsiao. There were four of us appointed.

Senator Curtis. Who were the other three members?

Mr. Hsiao. The other three members are Ernest J. Moorhead, who is an eminent actuary, and retired; and James Hickman, professor of actuarial science and statistics at the University of Wisconsin; and also Prof. Peter Diamond, professor of economics, Massachusetts Institute of Technology, plus myself as the chairman.

Senator Curtis. And earlier in your testimony did you give your background?

Mr. Hsiao. No, I did not, other than I think what is in front of you. I am an associate professor of economics at Harvard University. I am an actuary and an economist.

Senator Curtis. In your appearance here this morning you are appearing for the group of four?

Mr. Hsiao. That is correct, yes.

Senator Curtis. And when did you file your report? Do you have a written report?

Mr. Hsiao. We actually filed the report in April 1976, Senator Curtis, and it is printed by order of your committee.

Senator Curtis. Yes. I was aware of that but I didn't recall all the circumstances, who all was in there, and I think you have rendered a very helpful service here.

Senator Curtis. May I ask, do you happen to know, Dr. Myers, the trustees—do they have an advisory committee, too?

Mr. Myers. Senator, as you will recall, there is an Advisory Council on Social Security that is appointed every 4 years.

Senator Curtis. It is a continuing body?

Mr. Myers. It is appointed every 4 years and it is to be appointed after February of this year, so the administration now, I understand, is considering various members of the public for this advisory council. It also is supposed to study the matter this year and submit a report by the end of next year.

This council is usually 12 people, drawn from the general public with equal representation from labor and management—usually it has been three representing labor and three management—and with the remaining six representing the general public.

Senator Curtis. Yes, sir. Now have they had a report that—if it doesn't deal directly, but in the main—deals with the problem we are facing right now? Was it included in their last report, or is it too far back for that?

Mr. Myers. No, I think that their last report, which was submitted sometime in early 1975, directly faced most of the issues that are still before you. In their report they did recommend a number of financing recommendations. They also recommended decoupling by the wage-indexing method that I support.

Senator Curtis. My recollection is that while we have to allow for the fact that it was filed in 1975, that in general they followed, or—I withdraw that—in general their recommendations were along the same lines of reasoning as you have presented here this morning; isn't that correct?

Mr. Myers. In general, yes. There were a few differences.

Senator Curtis. So far as the trust fund is concerned and so far as not recommending general funds, is that correct?

Mr. Myers. That is correct. I should explain one recommendation that they did make. They recommended that the cash benefits program, OASDI, should continue to be supported solely by payroll taxes. They recommended, however, that the hospital insurance program should be supported in part by general revenues, and the tax rate from that program should be moved over into the necessary OASDI tax rate increases.

Senator Curtis. Well, again, I thank you for your appearance here, both of you. It has been very helpful.

Senator Danforth. I neglected to include in the list of administration proposals the proposal to reduce the reserve from 50 percent to 35 percent.

Could you comment on that proposal?

Mr. Hsiao. That is along the same line, trying to shift from one pocket to another pocket, or using bookkeeping methods to show the system is in better financial balance. I am against that. I believe the social security cash benefit program needs a reserve fund that is greater than 35 percent of the outgo.

Mr. Myers. I, too, would like to see a larger ratio than that. I would have preferred if we could have kept one years' balance, but we are not at that balance now and I can't foresee the possibility of getting back there. However, if it is decided to have a balance of only one-third of a year's outgo, I don't consider the money so involved as representing a savings. That is a misnomer to me, but in any event if the trust fund is left to decrease as it is doing now and gets down to that level, I think there are other ways of solving the situation than having this countercyclical financing out of general revenues.

As I mentioned very briefly in condensing my testimony, I think that there could be a loan provision repayable with interest as is intended to be done in the unemployment insurance program, although my first preference would be for a higher ratio.

Senator Danforth. Thank you.

Senator Nelson. Thank you very much, gentlemen.

Mr. Hsiao. Thank you.

[The prepared statements of Messrs. Hsiao and Myers follow. Oral testimony continues on p. 246.]

Statement of William C. Hsiao, Associate Professor of Economics, Harvard University

SUMMARY

There are two major problems confronting the financing of Social Security:

Large annual deficits of the cash benefit system which will exhaust its trust funds by 1981 and

Long-term problems caused by the double indexing of benefits and the demographic bulge.

Social security financing is complicated, but both short range and long range problems can be solved by the combination of the following measures which would completely restore the actuarial soundness of the system for the near and long term future:

Correct the double indexing problem by decoupling, however, price-indexing should be used to calculate the future benefits, instead of the wage-indexing method proposed by President Carter.

Raise the maximum taxable earnings base to $20,100, in 1978, instead of the $17,700 as expected under present law.

Increase the payroll tax rate by 0.3% on employer and employee each. This increase in tax rate can be phased in over the next four years.

The reform recommended above has the following advantages:

it protects Social Security benefits now and in the future against inflation while keeping the program cost at a reasonable level.

it preserves flexibility and control for Congress to improve the program in the future;

it gives equitable treatment to retirees of different ages; and

it restores the financial soundness of the system for both the short run and the long run.

Many schemes have been proposed to use general revenues to finance Social Security. I believe that elderly Americans and American workers will be ill-served by general revenue financing because:

General revenue funds are limited and there are many other programs which appear to have more urgent claims on general revenues, such as welfare reform, tax reform, national health insurance, long-term care, etc.

Some advocates for general revenue financing believe that dipping into general revenues is desirable because they perceive payroll tax as regressive. However, that is an incomplete view of the whole system. The Social Secuity program, as a whole, is very progressive when we consider both the payroll tax contributed over a worker's lifetime and benefits earned. This progressive nature of the system is appropriate for a social insurance program. When critics take an incomplete view of Social Security by distorting the social insurance program into an annual "income transfer" system, they separate the contributions paid from benefits earned and perceive the tax in isolation as regressive. This distorted and partial view of Social Security does not alter the basic fact: Social Security in its entirety is very progressive. Lower paid workers receive proportionately higher benefits than those higher paid workers in relation to their respective contributions.

General revenue financing would weaken the earnings-related nature of the program. It could even jeopardize the long-range stability of the entire social security system, thwarting citizen expectations of retirement income protection.

STATEMENT

I am pleased to have the opportunity to appear before you this morning as you consider the best way to restore the financial soundness of the Social Security program. During 1975–1976, I have chaired the Consultant Panel on Social Security appointed at the request of the Senate Finance Committee and House Committee on Ways and Means. This panel consisted of a group of actuaries and economists. We spent a year studying various alternatives in an attempt to solve the financing problems of Social Security. The Panel has made a written report to the Senate Finance Committee. My testimony today presents the major recommendations made by the Consultant Panel.

Today the Social Security system is confronted with four major problems:

1. Serious financial deficit.—Once again, the newspaper headlines have raised the public's uneasiness about the financial integrity of the Social Security program. Simply put, the system pays out more money than it takes in. According to the 1977 annual report of the trustees, the OASDI program will have a total income of $89.1 billion in FY 1978, but will pay out $95.2 billion, and incur a deficit of $6.1 billion. This annual deficit is projected to grow in the future years.

In 1970, the OASDI trust funds were equal to 12 months of benefit outgo. Now they equal only about 5 months of benefits. Experts agree that if Congress takes no action to strengthen the financing of the system, the continuing deficits will deplete the trust funds by 1981.

The financial deficits in the short-run largely result from three factors: recent high rates of inflation; increases in unemployment; and the technical error in the automatic adjustments provision in benefits. In the long run, the deficits will become greater and more serious because of the technical error in the automatic provision and the demographic bulge.

2. Double indexing benefits.—In the past, all benefit increases in Social Security required Congressional action. The 1972 Amendment built into law automatic cost-of-living escalators. While adjusting benefits and taxable wages

for inflation is a good idea, the automatic indexing methods incorporated into the law were technically wrong. They result in a significant overadjustment for inflation. This technical error causes initial benefits to grow over time. Eventually a great many new retirees would receive benefits in excess of their retirement wages. These inflated benefits would place a severe financial strain on Social Security. As far as I know, all experts and students of Social Security believe that the current double indexing of benefits should be corrected.

3. Demographic bulge.—The recent swing from baby boom to baby slump will increase the number of retirees while reducing the number of workers. Today there are 30 beneficiaries per 100 workers. In another fifty years there will be 50 beneficiaries for every 100 workers. If the current pattern of benefit replacement ratio (i.e., the ratio of benefits to pre-retirement wages) is maintained, the tax rates would have to be raised by more than 50 percent, to 18% or 19% of taxable payroll, in order to finance these benefits.

4. More women in labor force.—Today, a majority of married couples have both spouses in the labor force. The current spouse benefit formula seemed appropriate during the early days of the program because fewer than one out of seven married women was in the labor force at that time. But this spouse benefit is not consonant with our present social and economic life. It is giving unfair and unequitable treatment to one-worker and two-worker families.

Alternatives of restoring financial soundness

While there are numerous ways to restore the financial soundness of Social Security, realistically there is only one approach for solving the short-run difficulty. Congress must provide additional revenues for the system. Any consideration of reducing benefits in order to reduce the deficit is undesirable and not politically viable. Additional revenue can be provided in three ways: by raising the taxable wage base; by using funds from general revenue; and by raising the Social Security payroll tax rate.

I am in favor of increasing the wage base to a point at which the entire earnings of approximately 90 percent of all workers are covered. In 1978, the estimated maximum would be $20,100 instead of the $17,700 expected under present law. This increase will provide an additional revenue of 4% to the system during the early years, but the gain will be much smaller in later years. I would like to make clear that raising the wage base by itself will not be sufficient to cover the deficits in the long run.

Many proposals advocate that Social Security be financed from the general revenues. One frequently cited rationale is that the payroll tax is regressive. If the tax is appraised in isolation, then it is regressive. But this is taking an excessively narrow view. A person's benefits are in part determined by his tax contributions. Both the benefits and contributions are based on the earnings of the worker. The benefit formula causes low-income workers to receive benefits that are proportionately higher than those of high-income workers. If the taxes and benefits are examined together, then the whole system, in fact, is progressive.

If general revenue financing is introduced because Social Security needs additional revenue, then we should be mindful that other worthy programs may have more urgent claims on general revenues. These may include programs such as welfare reform, housing, long-term care, and social services. Furthermore, general revenue financing of Social Security would weaken the earnings-related nature of the program. It could jeopardize the long-run stability of the entire system, leaving many workers' expectation of retirement income unfulfilled. For these reasons, I believe it is unwise to use general revenues to finance Social Security.

That, then, leaves payroll tax rates. The amount of additional financing required depends on the method that Congress chooses to correct the double indexing of benefits. Two methods have been proposed for providing the proper indexing of benefits. They have vastly different implications for the degree of control that Congress has on the program, total cost of the program, particularly to the next generation of workers, and equitable treatment among retirees of different ages.

Correct overindexing: Price-indexing method versus wage-indexing method

1. Flexibility and Congressional Control

There are two proposals before the Congressional committees to correct the overindexing problem. Both provide for automatic adjustments of benefits ac-

cording to changes in economic conditions. For those already receiving benefits, both approaches guarantee that their benefits will keep pace with the increases in the Consumer Price Index.

However, the two proposals differ in the computation of initial benefits for workers who retire in the future. The Consultant Panel on Social Security appointed at the request of the Senate Finance Committee and the House Committee on Ways and Means, recommended the price-indexing method. This method will implement the Congressional intent of 1972. The provisions will protect current workers against inflation through automatic adjustments in the formula used to compute initial retirement benefits. In other words, the benefits for workers retiring in future years will be protected against inflation. In addition, their initial benefits will tend to increase when their real wages increase.

On the other hand, President Carter has proposed a method of computing the initial retirement benefits by using the wage-indexing method. The aim of the wage-indexing method is to provide an initial retirement benefit that replaces a fixed ratio of a worker's pre-retirement wages. Under this scheme, it is assumed that the standards of living of workers are determined by their pre-retirement wages. Computation for the initial Social Security benefits should automatically be adjusted to the relative income of workers.

These two methods produce different guarantees of benefits to workers retiring in the future. The price-indexing method guarantees a moderate benefit and preserves a greater degree of control and flexibility for Congress to increase the benefit in the future while President Carter's proposal would make it totally automatic. In the Consultant Panel's report to the Congress, the members stated that we believe an element of flexibility would guarantee a benefit amount that is protected against inflation. Moreover, the benefits for future retirees would tend to increase even without future congressional action because of the rise in workers' productivity. Congress can further raise the benefits in light of the needs of retired people and the economic, social and demographic conditions prevailing at that time.

Meanwhile the supporters for the wage-indexing method believe that the Social Security system should be made fully automatic. These automatic adjustment provisions give a guarantee of benefits at a higher level which would reduce or eliminate the need for Congressional action.

2. Benefits promised and cost to finance them

The pay-as-you-go method of financing Social Security is akin to a chain letter. Taxes paid by current workers are immediately paid out to the presently retired people. The retirement benefits of current workers must be financed by the payroll tax contributions collected from the next generation of workers. Therefore whether the expectations of current workers can be realized depends upon whether next generations of workers are willing to pay the required taxes. If the promised benefits are unreasonably high, then the program will encounter financial difficulties.

The two alternatives proposed to correct overindexing guarantee different benefits. Correspondingly their respective costs are very different. The proposal made by President Carter requires the next generation of workers to pay a payroll tax that is 70% greater than what we pay now. Doubts have been expressed about whether future workers will be willing to pay such a significantly higher tax rate. At this time I would like to question whether it is fair or wise for current voters to bind our sons and daughters to a much higher tax rate than we are willing to pay ourselves.

A comparison of estimated costs of the benefit formula based on the price-indexing method and the wage-indexing method is presented in the following table. Social Security is a long-term program. Like any pension program, provisions may have little cost impact until later years when the program matures. Long-term projections are inherently quite complicated and based on assumptions. Nevertheless, the projections provide valuable indications as to what the future costs might be if the economic, social and demographic elements are not substantially different from past trends. The estimated costs shown below has been prepared by the Office of the Actuary of the Social Security Administration, using a set of intermediate assumptions. The price-indexing method produces expenditures which are relatively level as a percentage of taxable payroll. Meanwhile the wage-indexing method produces expenditures which require substantially greater tax payments from the next generation of workers. Presi-

dent Carter has not proposed how these large outlays would be financed in the long-run future.

COMPARISON OF OASDI LONG-RANGE COST

[In percent]

	Expenditures as percent of taxable paryoll[1]	
	Price-indexing method	President Carter's proposal
Year:		
1977	10.8	10.8
1980	10.6	10.7
1990	10.5	11.8
2000	10.0	12.4
2010	10.0	13.4
2020	11.5	16.5
2030	12.5	18.9
2040	11.9	18.9
2050	11.3	18.8

[1] 1 percent of taxable payroll equals $8,000,000,000 in 1977.

3. Unequal treatment of retirees of different ages

The price-indexing method of correcting the double indexing problem guarantees that the retirement benefits of all are protected against inflation—people who have retired and people who will retire in the future. It leaves some financial flexibility for Congress to give periodic general benefit increases to everyone: currently retired people and workers retiring in the future.

In contrast to this, the benefit formula proposed by President Carter provides a tilt in favor of workers retiring in the future. The increase in benefits for the current retirees is limited to increases in the rise in the Consumer Price Index, yet workers who retire five years later will receive increments due to inflation as well as increases in real wages. This difference can be substantial. For example, we can look at three workers whose lifetime earnings are in the same relative position. Their earnings reflect the average in the total economy. However, one man was born in 1911 and retired in 1976; one was born five years later, in 1916, and retires in 1981; the third was born in 1926 and retires in 1991. The method proposed by the Administration will guarantee the following benefits.

MONTHLY RETIREMENT BENEFIT (EXCLUDING SPOUSE BENEFIT) IN 1976 DOLLARS FOR MEDIAN EARNERS

	Year of retirement	Benefit amount (in constant 1976 dollars)
Year of birth:		
1911	1976	$347
1916	1981	413
1926	1991	521

Measured in constant purchasing power, the man retiring in 1981 will receive 19 percent more in monthly retirement benefits than the man who retired in 1976. The man who retires in 1991 will receive 50 percent more in monthly benefits than the person who retired in 1976.

STATEMENT OF ROBERT J. MYERS

SUMMARY

1. Financial problems confronting the Social Security program are serious but can be solved readily.

2. The short-range problem should be solved by an immediate increase in the tax rate on both employers and employees of ½ percent. The self-employed

rate should be restored to the initial basis of 1½ times the employee rate. The maximum taxable earnings base should not be increased any more than the automatics will do. A government subsidy should not be injected into the program.

3. Decoupling of the computation of initial benefits should be done by wage indexing of the earnings record at a 10 percent lower relative level than the current one, which will produce higher benefits in both dollars and purchasing power. A permanent savings clause should apply such that benefits will never be less than under the present law as it now stands.

4. Decoupling by price indexing of the earnings record is not a viable or desirable approach, nor is the present procedure revised to use a final-average wage. Decoupling by using the present method revised by including a cap of 55 percent of the wage increase if less than the CPI increase would be satisfactory.

5. The present method of increasing benefits for those on the rolls is satisfactory.

6. As to long-range financing, a further ¼ percent taxe rate increase would be needed under my decoupling recommendation in the mid-1980s, or ½ percent under the Carter Administration proposal. After 30 years, a further rate increase may be needed, depending upon future experience as to fertility and retirement rates.

7. The desirable level of the trust-fund ratio can be based on other considerations than government subsidies, as under the Carter Administration proposal.

STATEMENT

Mr. Chairman and Members of the Committee: I am currently Professor of Actuarial Science at Temple University, and I also do extensive consulting work in the field of Social Security benefits.

I was Chief Actuary of the Social Security Administration from 1947 until my resignation in 1970. Before 1947 and back to 1934, I held other actuarial positions with the Social Security Administration and its predecessor agencies. As to my professional qualifications, I am a Fellow of the Society of Actuaries and a Member of the American Academy of Actuaries.

The views that I am expressing here are solely my own and are not necessarily those of any organizations with which I am affiliated.

The financial condition of the Social Security program, Old-Age, Survivors, and Disability Insurance, have been a matter of wide public discussion in the past three years. Much of such discussion has tended to be on the sensational side and has greatly overstressed the financing problems of OASDI. The public might now almost feel that, because no legislative action has yet been taken, and because checks are still going out to the beneficiaries each month, no financial problems really exist and that somebody is "crying wolf."

Such is not the case. Serious financial problems are present in OASDI, both of a short-range nature and a long-range nature, but solutions are readily possible. My testimony will be devoted to the financing problems of OASDI and how, in my view, they can best be solved.

WHAT ARE THE PROBLEMS?

Briefly, the short-range financing problem of the OASDI system is that the trust funds will soon run out of money unless legislative action is taken. The OASI Trust Fund will be exhausted at some time in 1982–84, while the DI Trust Fund will run out of money in 1979, according to the 1977 Trustee Report. In fact, under adverse conditions, it is possible that the DI Trust Fund could even be exhausted somewhat before the end of next year.

The long-range financing problem is a little less apparent, but is equally serious and significant. The average long-range cost of the program (over the next 75 years), as shown by the intermediate estimate in the 1977 Trustees Report, is 8.2 percent of taxable payroll in excess of the average tax income. This is a relative cost over-run of 75 percent.

It will be recalled that, prior to 1972, any such lack of actuarial balance in excess of 0.1 percent was considered to be unacceptable and thus indicative of the need for prompt remedial action. Following the 1972 Amendments, with their automatic-adjustment features and thus the need for using dynamic

economic assumptions in the actuarial cost estimates, this acceptable margin was increased to 0.50 percent. So, at present, the imbalance is far in excess of what has been considered to be acceptable.

SOLVING THE SHORT-RANGE PROBLEM

Quite simply, the short-range problem can be solved either by a reduction in outgo or an increase in income (or a combination of the two). It seems that the most likely solution for the short-range problem would be an increase in the income of the trust funds.

Increased income can be derived from only three sources—higher tax rates, higher taxable earnings bases than those which would otherwise result under the automatic-adjustment provisions, and subsidies from the General Treasury (i.e., from general revenues or by increasing the budget deficit, through borrowing). Tax increases are, of course, not popular. However, there has been less sentiment against them under OASDI, because the general public has in mind its "insurance" nature.

In my opinion, the approach of increasing tax rates is by far the very best one, because it forthrightly and clearlp assesses the cost against all participants. The public will thus recognize the financing problems of the program and will share openly and universally in the solution. At the same time, I believe that the arbitrary ceiling of 7 percent for the self-employed rate should be eliminated and that the original basis of 1½ times the employee rate should be restored.

Others have recommended instead that the maximum taxable earnings base should be increase far more than the automatic-adjustment provision would do. This procedure can produce a considerably increase income in the early years, but over the long run it is not very cost-effective, because additional long-range benefit liabilities also develop. I oppose this approach because it is cost deceptive to the general public and because it narrows the scope of the economic security field which can, and should, be taken care of by the private sector.

The remaining method of solving the short-run financing problem of OASDI is to inject a government subsidy on a one-time or a continuing basis, possibly to the extent of paying for one-third of the total cost of the program in this way. I believe that this approach is undesirable because it hides the cost aspects of the program from the public, many of whom would be deceived thereby into believing that somebody else is paying for part of the cost of their Social Security benefits. Actually, the cost of a government subsidy to OASDI would be met by virtually the same people who pay OASDI taxes, although the incidence of the taxation might be somewhat different. In fact, it is difficult—if not impossible—to measure the ultimate impact of any tax, even though it is great intellectual sport to attempt to do so.

Specifically, I believe that the short-range financing problem of OASDI should be solved by an immediate increase in both the employer and employee tax rates of 0.5%. This could perhaps be phased in over a 2-year period, such that part of it would come into effect in 1978 and the remainder in 1979. Such an increase, as this subcommittee knows, is nothing new or unusual. Many such increases have been made in years gone by without serious effects or adverse reactions from the general public. At the same time, the allocation of the tax between the OASI and DI Trust Funds would be revised so as to give a somewhat larger proportion to the latter than under the present law, in order to remedy its more serious financial situation.

I oppose any transfer of the payroll taxes for the Hospital Insurance system to OASDI. The 1977 Trustees Report shows that HI also has serious financing problems in the next decade. Even if the cost containment proposal of the Carter Administration were enacted and were successful, or if other cost control provisions were provided, the HI program would need all the financing through tax-rate increases that would be provided under existing law.

DECOUPLING AS PARTIAL SOLUTION TO LONG-RANGE PROBLEM

Now, let us turn to the long-range financing problems of OASDI that remain after the short-range ones are taken care of. The first and most urgent thing to be done is to restructure the method of computing benefit amounts at initial

claim under the automatic-adjustment provisions. However, the present procedure for increasing benefits for persons on the roll should be left unchanged, because this does operate properly.

As these intial-computation procedures will likely operate in the future, relative benefit levels or replacement ratios will steadily rise in the future. And, of course, the same thing will happen as to the cost of the program. Eventually, benefit amounts will reach illogical levels, such as being in excess of pre-retirement take-home pay. Proper restructuring of the computation procedures (popularly referred to as "decoupling") would eliminate at least half of the long-run actuarial deficit shown in the intermediate cost estimates in the 1977 Trustee Report.

The present computation procedure for OASDI benefits is "coupled". This has been so, not only for the automatic-adjustment provisions adopted in 1972, but also in previous legislation that provided ad hoc benefit increases. This procedure worked out well in the 1950s and 1960s, both from a benefit-design standpoint and as to the financing results, because—as it so happened—economic conditions then were just right so as to achieve such a result. Under current economic conditions, and those that seem likely for the future, this result will not prevail, but rather that the instability referred to previously will occur. This coupled procedure also desirably gives equal treatment to beneficiaries with the same average wage, regardless of when they retire.

Under a coupled system, when a percentage increase is given to beneficiaries on the roll, the percentage factors in the formula for primary benefits applicable to new retirees are increased to the same extent. For example, the formula applicable for June 1975 through May 1976 could be expressed approximately as 46.5 percent of average monthly wage, plus $92. After the 6.4 percent increase for June 1976 for beneficiaries on the roll, the formula became 49.5 percent of average monthly wage, plus $98. Actually, the exact formula involves some eight steps of average-wage bands, and the percentage factor applicable to each of them was increased by 6.4 percent.

Under decoupling, the benefit increases for those on the roll would continue to be made as at present (i.e., by the percentage change in the Consumer Price Index). However benefits for new claimants would be calculated in a different manner than now. The result would be that benefits would not be as sensitive to differing rates of change of prices and wages—and, in fact, under some decoupling approaches would not be at all sensitive thereto.

The 1975 Advisory Council on Social Security developed general principles for a decoupling approach which would completely stabilize the relative benefit level. This recommendation was made specific in a bill developed by the Ford Administration in 1976 (H.R. 14430), and it has also been made by the Carter Administration. In both instances, the ultimate relative benefit level would be at about the same height as it will be under present law just before the new procedure becomes effective.

I strongly support this approach of stabilizing the replecement ratios. However, I believe that such stabilization should occur at a slightly lower level (say, 10 percent) so as to recognize the relative over-expansion of the benefit level in the last few years—in part due to the faulty action of the computation procedures.

Under the general approach of decoupling by indexing by wages, there would be a new concept of average earnings and a new benefit formula. The previous benefit computation method frozen as to the changeover date would be a transitional minimum guarantee or savings clause for retirees.

The average earnings under the new basis, the Average Indexed Monthly Earnings (or AIME), would be determined as at present as to the period of averaging and the number of years to be averaged, but it would be based on wage-indexed earnings, rather than actual earnings. Under the recommendations of the Ford and Carter Administrations, a new benefit formula intended to duplicate closely the results under the present formula as of the changeover date would be used. Under my proposal, the new formula would produce slightly lower amounts for many cases in the first few years of the changeover; under these circumstances, however, the aforementioned savings clause would apply, and no retiree would get less than under present law as it would provide as of the changeover date. The indexing of an individual's earnings for any particular year would merely be his or her actual earnings for that year multiplied by the ratio of (a) the average wage in covered employment in the

year to which indexing is being done, to (b) such average wage for the particular year. The average of the indexed earnings will, of course, be larger than the average of the actual ones.

The revised benefit formula for the wage-indexing method would be a 3-step one in the general form X percent of the first \$A of AIME, plus Y percent of the next \$B of AIME, plus Z percent of the AIME in excess of \$(X + Y). The benefit percentages, (X, Y, and Z) would be of a decreasing nature, so as to provide relatively larger benefits for lower-paid workers, just as in the formula of present law.

This formula would be changed each year, for new claimants then, by adjusting the dollar bands according to changes in covered employment. For example, if such wages increase 8 percent from one year to the next, the formula would be changed by multiplying each of the AIME dollar bands by 1.08.

A somewhat different method of decoupling has been proposed by a consultant panel to the Congressional Research Service. Its approach differs from that just described primarily only by having the indexing of the earnings record done with the CPI, rather than with average wages in covered employment.

The effect of the panel's approach would be to produce a lower AIME's because the CPI has generally risen less rapidly than wages in the past. This difference in AIME concept is compensated for by using generally larger factors in the benefit formula. Such formula intially would, on the average, closely duplicate the reults of the benefit formula in present law. The AIME bands would be changed each year by the movement in the CPI.

The apparent—and I stress "apparent" for reasons which I will bring out later—long-range result of the CPI decoupling procedure would, however, likely be to produce decreasing relative benefits or replacement ratios over future years (although benefit amounts that would rise in terms of dollars and would maintain the purchasing power of the benefits). In turn, this would mean that, apparently, the CPI approach would eliminate a much larger proportion of the presently-estimated long-range actuarial deficit than would the wage-indexing approach. But, as will be brought out subsequently, this highly desirable result is actually only a mirage, because the proposal is of an unstable nature, both logically and politically, and so ad hoc benefit increases would most certainly be made in the future.

The illogical mixture of both price and wage elements in the computation of intial benefit amounts that is present in current law would continue to be present under the CPI indexing method. On the other hand, the wage-indexing approach maintains consistency by using only earnings elements.

Under the CPI procedure, taking into consideration likely future economic conditions, the replacement ratios would continually decrease over the future, unless ad hoc benefit increases were legislated. This decreasing trend seems irrational from a pension-planning standpoint. It would seem difficult, under these circumstances, for private pension plans to supplement OASDI. If the private plan assumed that OASDI benefits would decrease relative to final earnings, it would have the potential danger that such benefits would actually be increased on an ad hoc basis and that then its own benefit level would be too high and thus too costly.

Young persons particularly would feel that the CPI procedure is unfair. They would receive relatively lower benefits than the current older generation, despite their paying much higher OASDI taxes, not only in dollars but also as percentages of their earnings.

The advocates of the CPI procedure might claim that Congress will prevent replacement ratios from decreasing in the future, through ad hoc legislation. But is it logical to develop a benefit structure that will almost inevitably result in an undesirable situation, which must necessarily be changed? Ad hoc legislative patchwork of an automatic-adjustment system could well produce a result as irrational as the present basis.

I believe that OASDI should be automatically adjusted on a basis that will result in relative stability of the benefit level (as the wage-indexing procedure would do). The CPI method attempts to "walk on both sides of the street at the same time". You just cannot have it both ways—dangling the prospect of eliminating the financial problems of OASDI by CPI-decoupling before those to whom this will appeal, while at the same time assuring others concerned about benefit adequacy that deterioration will never really occur because there will surely be ad hoc legislative changes in the future.

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Returning to the subject of decoupling by wage-indexing, some persons might object because it is such a great change from the present procedure and because the concept of indexing is difficult to understand. What other possibilities for the necessary decoupling exist?

Perhaps the first thing that comes to mind is merely to use a final average-wage approach, such as is successfully done under the Civil Service Retirement system and under many private pension plans. Combined with this, the weighted benefit formula would be adjusted annually by changing the dollar bands according to variations in the general wage level. Such an approach would not work out well in a nationwide system such as OASDI, because of the manipulation—intentional or otherwise—possible by acquiring a high earnings record in the last few years. This could particularly be done by government employees who are not under OASDI and who take early retirement and then enter covered employment.

Another possible procedure is one that I developed several years ago. The benefit-computation procedures would be exactly the same as at present, except that, when adjusting the benefit formula under the automatic provisions, the benefit percentages would be increased by the lesser of (1) 55 percent of the percentage increase in the general wage level or (2) the percentage increase in the Consumer Price Index—instead of only by the latter, as at present. The effect of this procedure would be to approximately stabilize replacement ratios, although not necessarily at any prescribed or planned for level in advance.

Actually, under likely future economic conditions, such stabilization of replacement ratios would occur at a level slightly lower than the presently emerging ones. As I indicated previously, this is a desirable result—both from a long-range financing standpoint and as a recognition of the over-expansion of the benefit level in the past few years.

The advantage of this procedure is that it would require relatively few changes in existing law and administrative procedures. There are, however. some disadvantages. First, one cannot explain, with any mathematical proof or logic, why the limitation of about 55 percent of the wage increase produces the desired result of stability of replacement ratios (although model calculations demonstrate that it does so for a very wide variety of economic conditions). Second, the level at which replacement ratios are stabilized will vary somewhat depending upon economic conditions and cannot be established conclusively at a desired level, as is possible under the wage indexing method. However, I should emphasize that such level will not vary greatly from that presently prevailing, and under current economic conditions will be slightly lower, which has a favorable effect in reducing the long-range imbalance.

In balance, I believe that the wage-indexing procedure of decoupling (preferably with about a 10-percent lower ultimate level for the replacement ratios) is superior to the procedure just described of using the present basis modified only so as to have a cap on the relative increases in the percentage benefit factors that would be based on 55 percent of the increase in the general wage level.

THE SOLUTION OF THE REMAINDER OF THE LONG-RANGE PROBLEM

If decoupling were accomplished by wage indexing with ultimate replacement ratios being 10 percent lower than those for current claimants (but with a permanent savings clause being applicable so that nobody will get less than under the present formula as would be on the changeover date), and if the short-range financing problems were solved by an increase of ½% in the employer and employee tax rates, it seems likely that the only additional financing needed for at least the next three decades would be an increase of ¼% each some time in the 1980's. If decoupling is done at present replacement-ratio levels, such increase would have to be about ½%.

In about 30 years, however, a further financing problem would arise under current estimates as a result of the great changes expected in the demographic situation then. The solution, I believe, would be to increase the tax rates sizably beginning in about the year 2011 (at which time, under present law, a 1 percent increase in both the employer and employee rates is already scheduled. It is by no means certain at this time how much increase will then be required. A great deal will depend upon such uncertain elements as future fertility and mortality trends and, equally importantly, retirements-rate trends.

I believe that, after the year 2000, when labor market shortages may show up as a result of current and future low fertility, retirements will tend to be more deferred than the present experience indicates. This can be an important cost-reducing factor for OASDI. As a result, if this occurs, the tax rates estimated to be necessary three decades hence may not need to be as high as now seems to be the case.

Another possibility that has been suggested is a long somewhat similar lines—namely, that the minimum retirement age for full benefits should be gradually increased from the present 65 to something like 68, beginning about 30 years from now and phased in over a period of several years. Such proposals now meet with a great lack of enthusiasm from the general public. However, it is conceivable that, several decads from now, this might well be feasible as contrasted with having higher taxes for OASDI.

Still another factor to be considered is that higher tax rates for OASDI several decades from now may not be too burdensome, if, at the same time, lower taxes are needed for items associated with children, such as public education. Certainly, this should eventuate if the demographic situation is such that there are relatively far fewer children in the population than currently.

DESIRABLE SIZE OF TRUST FUNDS

Next I should like to discuss the question as to what is the desirable size of the OASI and DI Trust Funds. Ideally, in my opinion, they should average about one year's outgo. They should be somewhat higher than this during good economic times, and then somewhat lower during poor economic times. However, considering what has happened to this relationship in the last few years, which was the result not only of reduced economic activity, but also of inadequate tax rate levels earlier, I do not believe that this relationship can ever be restored in the future.

There is no definite actuarial determination possible of the optimum average size of the trust funds. I would say that we must proceed from where we are now or are likely to be before remedial legislative action occurs. Specifically, I believe that, if certain actions are taken that I will next enumerate, it will be sufficient if the trust fund balance is at the level of about four months' outgo.

The Administration proposal would justify this level of the trust funds on the basis of providing a government subsidy in times of high employment, which is labeled as a counter-cyclical financing mechanism. I have previously indicated that I oppose this approach for the reason that any government subsidy to the program is undesirable. Further, I seriously question the validity of the estimated computed amounts of taxes lost because of high unemployment in 1975–78 ($14.1 billion).

Instead, there might be considered another approach by which the same ends could be achieved. Such a relatively low trust-fund-balance situation would be satisfactory if the trust funds were granted borrowing autho-rity from the General Treasury. Such loans would be repayable with appropriate interest in specified times of lower unemployment. Interest would be computed in exactly the same manner as is now done in reverse when reimbursement to the OASI Trust Fund is made by the General Treasury for the special age-72 benefits. The general procedure for loans to the trust funds proposed here is in accordance with what is already being done in the Unemployment Insurance program.

The proposal of the Carter Administration to have so-called counter-cyclical financing through a government subsidy is described as producing a "savings" of some $24 billion as a result of a lower trust-fund ratio being suitable. I hardly think that it is proper to call this procedure a "savings". In any event, the same result of a lower trust-fund ratio could safely be achieved in other ways.

CONCLUSION

In concluding, may I express my hope that the Congress will soon take action on remedying the financing problems of the Social Security system and thereby restore its financial integrity. This is necessary so as to alleviate the fears of the people of our country. Many now are deeply concerned that the floor of economic security that they had been planning on will not be there when needed.

Senator NELSON. Our final witness is Dr. Otto Eckstein, former member of the President's Council of Economic Advisers, presently president of Data Resources, Inc.

The committee is pleased to have you here again, Dr. Eckstein.

Your statement will be printed in full in the record and you may present it however you desire.

STATEMENT OF OTTO ECKSTEIN, PRESIDENT, DATA RESOURCES, INC., PAUL M. WARBURG PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. ECKSTEIN. With the consent of the committee, I shall be very brief, since lunchtime is upon us, and I do assume, as you indicated, you will print the entire statement in the record setting forth my views rather carefully and at some length.

Senator NELSON. You may take whatever time you desire. I don't go to lunch.

Mr. ECKSTEIN. Let me then quickly summarize the main themes of my testimony, and let me say that I found this very difficult testimony to write.

I am a longtime participant in social security matters. I am as loyal to the social security system as everyone else who usually forms a protective ring around it; but I could not help reach the conclusion that the social security system is really in need of a more drastic reform than the administration's proposals or anybody else's proposal at this time suggest: and the problem is very simple.

The problem is on the expenditure side. We have before us the administration's proposal which would finance all of the good intentions for social security and would indeed overfinance them, providing a surplus at least for a period in the early 1980's. This increase in expenditures would be financed by the imposition of what is in effect a new major source of revenue for the social security system, a tax on professional and executive salaries which would provide revenue but would for the first time in the history of the system have no association with benefits at all.

Now if one digs into the substance of the social security system at this time, it turns out that the problem is really somewhat different than it is presented. The problem is not that the pensions are insecure or that the trust fund that pertains to retirement pension is in deep trouble. As table I in my testimony, on page 3, shows, the deficit in the old-age and survivors' insurance fund is quite moderate and would in the ordinary course of events be partly closed by a recovering economy.

The deficit is in fact nearly half on the disability side and this disability fund is running at a deficit of about 20 percent of its outlays.

The question then becomes, how serious is that and what are the long-range implications?

If you analyze the long-range projections of the disability fund, it turns out it is very serious indeed and the projection of this fund suggests that it will have increased by the year 2001, would raise its percentage of taxable payrolls, the most meaningful measure, by 82

percent, whereas the increase in the traditional old-age and survivors' fund is only 11 percent; thus the long-range problem is heavily on the disability side and the short-range problem is very heavily on the disability side.

The question then becomes, Is the disability fund being managed in a suitable fashion? Are the eligibility standards proper? And the answer is "No."

The Congress has liberalized the eligibility rules in a variety of ways. We started out with a permanent disability concept and a 1-year waiting period. We now have a 1-year disability concept and a 5-month waiting period.

As the study which I footnote on page 3 reports, we have reached a state where hardly anyone recovers from disability and we also have other reports that the administration of the medical standards that define disability vary very widely around the country.

Now that is the single biggest problem in the social security system. It is a much bigger problem than actuarial soundness.

A second abuse already alluded to at length in the earlier testimony this morning and in the questions of Senator Danforth is the rising problem of multiple membership in public retirement plans.

Senator NELSON. Before you go to the next subject, may I ask a question?

At the bottom of page 2 you state that in 1967 3.21 percent of all beneficiaries recovered from disability and ceased to receive benefits, in 1975 only 1 percent. This, I take it, is an annual recovery percentage of those who are discovered; is that right?

Mr. ECKSTEIN. That is correct.

Senator NELSON. Before you leave that, you stated that you have broadened eligibility requirements, that standards have loosened and so forth. Do you have some specific proposals?

Senator DANFORTH. Mr. Chairman, before Professor Eckstein answers, I wondered what the Chair's views were. Are we going to go and vote and come back?

Senator NELSON. Is there a vote on?

Senator DANFORTH. Yes.

Senator NELSON. You vote for me. I will trust you. [Laughter.] We will come back in 10 minutes.

[Short recess.]

Senator NELSON. Sorry about the interruption. I was asking about the disability fund and the standards and whether you had some suggestions, some specific suggestions about them.

Mr. ECKSTEIN. No, sir, Senator. I simply am reporting the basic facts on the disability fund. I think it is very difficult to sort out to what extent it is the recession which changes people's attitudes toward it, to what extent it is statutory changes, or to what extent it is administrative changes. The proper congressional response to the disability situation is to appoint some independent study that will report back to you why this fund has become so costly so quickly and why its prospects are for a very, very dramatic further increase in cost.

Senator NELSON. Thank you.

Mr. ECKSTEIN. As I mentioned, the question of public employees was discussed this morning. There is a pretty universal agreement

that some integration is desirable. There are various ways to do it. It is a revenue windfall to the system, as I calculate it quickly at the hearing. It is several billion dollars that the Federal Government would contribute for its employees to the social security fund.

Senator NELSON. What?

Mr. ECKSTEIN. If the Federal employees had to be covered by social security, and if the Federal Government therefore contributed the taxes on its 2.5 million employees, it would be several billion dollars a year.

Senator NELSON. Would it have any long-term impact on the fund?

Mr. ECKSTEIN. In the long run these employees would have also an entitlement to benefits but it is a fact one of the ways one could aid the fund in the short run is to make the Federal employees eligible, although it is, of course, a burden on the rest of the Federal budget.

In the case of State and local governments, if that were made mandatory, it would be a tax burden on them. There are ways.

Senator NELSON. Wisconsin simply integrated them many, many years ago. When the contribution to social security went up, the contribution to the State retirement fund went down; so your benefit from the Wisconsin retirement fund would be reduced; your benefit would increase in the social security fund.

Now, if you did it that way, I assume it wouldn't have any significant consequences on the Federal budget, would it?

Mr. ECKSTEIN. That is the arrangement my university has also, but if it were actually carried out, one would have to negotiate with the civil service unions and so on. What the adjustment would be in the Federal pension is not totally predictable. Clearly, some form of integration would be beneficial to the social security fund because at the moment they are suffering from the lack of contribution by the Federal Government but are burdened by the benefits paid out to Federal employes.

Senator NELSON. Thank you.

Mr. ECKSTEIN. A third major area which has also long been recognized by the Advisory Council is the minimum benefit which has really changed its meaning over the last 20 years, which today mainly compounds other abuses. It is the minimum benefit which leads to sizable payouts to people who have paid in very little, and the blue book that the staff prepared shows that the replacement rate at the minimum benefit level is 146 percent.

Now let me turn to the President's proposals for a moment.

I do believe that we want to keep the system as it is; we want the trust fund to survive; we want the public to continue to have justified confidence that in fact it will receive the benefits when it retires, and this clearly requires that there be a major infusion of money.

Now, the first of the proposals, the general revenue sharing, is a minor proposal. I suppose I partly deserve the blame for I recommended it to the Senate Budget Committee 1½ years ago, and it was not received very well then; it isn't being received very well now, but I would still urge you to view that proposal with an open mind for a moment.

What that proposal really does is to ask the Government to make a symbolic gesture that it will agree to transfer some of its General Treasury claims to the trust fund, strengthen the trust fund by what

is admittedly entirely a bookkeeping transaction. It has no impact on the Federal budget, has no impact on the economy; it is simply when you look through it, it is a symbolic statement by the Federal Government that it recognizes that it has a larger moral obligation to the trust fund than the present dollar amount; it says, in a sense, the Government owes the trust fund some billions which they lost because the economy got so sick, which was——

Senator NELSON. Are you referring to both the $14 billion and the 6-percent guarantee?

Mr. ECKSTEIN. Well, no; the guarantee is a separate matter, but the $14 billion is an estimate of what the system lost through unemployment.

My calculations which were based on the first half of the recession were only $5.5 billion. If you add on 1976, 1977, and 1978, you wind up with a number in the $10 billion to $14 billion area.

Now—so that is truly a loss of the trust fund caused by the recession. I don't think it is an important proposal because it is entirely symbolic. It does not solve any long-term financing problem, has no pertinence to fiscal policy, budget policy; it is a gesture that would be wise to undertake, but it is not the main issue before your committee.

On the question of the employer tax, which is the heart of the proposals, that is the bulk of the incremental money beyond the previous legislation, it consists of the removal of the ceiling on employer contributions.

Now, it is one of these ideas, if you think about it, that grows on you. My initial reaction was quite negative since my own company would pay a great deal of it; so would universities——

Senator NELSON. An employer tax?

Mr. ECKSTEIN. From a public finance point of view, it is a progressive tax. To the extent that it is shifted back to individuals, it is shifted to individuals with high incomes; it does nibble at some tax loopholes.

For instance, the incorporation of professional individuals has been one of the more annoying loophooles in the tax law. Those professionals would now have to pay this 6.3-percent payroll tax on their full pay. It would get after that a little bit. If the large corporations feel they want to pay very large salaries, presumably they should be willing to pay the 6.3-percent tax on them.

I would call to your attention it is a sizable sum. On the million dollar salaries which a few companies are approaching, it is a $63,000 tax on one individual's salary.

Senator NELSON. But then you say it would cost the company a good deal of money; however, in the alternative, I assume that if you raised the tax base on both the employers and employees, the cost to the employers—according to the administration's statistics—following "this traditional route of taxing both," would be $4 billion more than following the administration's proposal. Do you agree with that?

Mr. ECKSTEIN. As far as the incidence among employers is concerned, I think it is justifiable. What it does, it taxes those employers more who have high-paid employees, which are professional organi-

zations. It is favorable to people like McDonald's who have a lot of low-paid employees. Since one of our big economic problems is to get a lot of people back to work, including young workers with low productivity, a tax change which is relatively favorable to low-wage workers and unfavorable to the high-wage workers is probably desirable. So the tax grows on you, but there are two questions about it:

The first is whether it has too loose a connection to benefits and thereby impairs the basic logic of the social security; and the other question is whether the Congress should give social security this enormous revenue source before you have turned seriously to the reform of the expenditure side; and my conclusion is that once you provide the money, you can forget the expenditure reforming. That is the usual history of such matters.

If you raise the rate, you produce a tremendous increase in revenue. You have really given this particular group an access to Government money that is unique, and social security is not the only program; it is not even the only social program, and you will lose a check and balance of this program against other programs if you are that generous.

It is like enacting what is almost a value-added tax, as your chairman has discussed, but earmarking it for one program.

One final question which I have to deal with is indexing. Again, I will try to stand a little back from it and look at it in a little more practical, long-range way.

You must fix overindexing because if you do not fix it, the claims that will ultimately materialize are so astronomical you will ultimately force the Government to renege on its commitment. You should fix it soon because the longer it goes on, the more difficult it becomes to fix.

Now, between the two methods, the price escalation and the wage escalation, of course, from the point of view of the program and its beneficiaries, wage escalation is much more desirable because it means the retired worker fully participates in the continuing advance in real productivity with the working population; and ideally, one would wish to have a retiree benefit not only from full protection against inflation but also in addition to that the extra benefit of increasing real productivity.

However, I would urge you not to go to that extreme proposal at this time, but to limit it either to price escalation or to some of the proposals that go somewhat beyond price escalation but not to the full wage escalation; and the reasons are these:

We do not know what the longrun future holds. The uncertainties are very great. We have already listened to experts this morning. We are beginning to hear talk about the hope that the decline in the number of children will save State and local outlays, a very dubious hope.

We are already beginning to hope that retirement ages will creep up, even though we have spent 20 years driving them down by Government policy. If we are already driven to recourses such as this, it sounds to me that we will be well advised not to commit all the resources we would have to one formula this early.

Let me mention one other consideration.

The social security system over the next 5 or 10 years will incur major expenditures not now on the agenda. The system as it exists today is unfair to the working wife. The typical working wife, with near median women's income, receives virtually no benefit for a lifetime of contributions.

It is possible that the courts will decide the present setup is unconstitutional. It is much more likely that the women's movement will ultimately decide that this is a major cause for reform and will force the Congress to change that aspect of the program, and we are talking about very large outlays.

Furthermore, as the witnesses this morning indicated, there are a variety of other unknown circumstances—demographic, social, and economic areas—that make it unwise to commit every penny this early for the next 25 or 50 years; so I think this is an overambitious goal, which today's economic uncertainties do not really allow. We cannot enter into a commitment to workers that we will fully escalate their benefits in line with real productivity beyond the inflation protection.

One final matter: I summarize in my testimony a study of short-term economic effects. In the short run, it is insensible to analyze the administration's proposals vis-a-vis in action, because we know we would not let the fund go broke and it never was a realistic alternative. We have assumed action would be taken which would bring the total social security into some kind of balance so the input we are measuring is only where the administration goes beyond the goal to save the trust fund, to actually have these funds contribute a surplus to the budget, toward the Government goal of budget balance.

In effect, that is what the administration's proposal amounts to. So when you take that incremental $4 billion or $5 billion that go beyond near balancing to a surplus, then you have a loss of real purchasing power; you have extra inflation.

But the amounts are small compared to the energy program. We are talking here of a magnitude that is perhaps 20 percent as large. The total increase in the price level here is only half a percent at most, and the total energy program would raise the price level 2 or 3 percent. The loss in the level GNP is half a percent, whereas in the energy program it is half a percent a year, which, again, adds up to several percentage points. Thank you.

Senator NELSON. Do you have some questions?

Senator DANFORTH. I really feel that you have been short-changed, Professor Eckstein. You are a very eminent economist, and we have had one vote right at the outset of your testimony, and now we have got the bell ringing for another one. That is unfortunately the way it goes around here, but I very much appreciate your coming and I will read your comments with great interest and I am sorry that you didn't get the full attention that I would have liked to have given you.

I hope you will come back and not view this as a typical performance, although it probably is more typical than we would like.

Senator NELSON. Well, let me endorse what Senator Danforth said. We may want to submit a few questions to you, one of them on the effect on the economy of going the conventional route, which you

commented on briefly. And when we get together some proposals, it would be my intent, time permitting, to ask for further comments from witnesses such as yourself. I am sure there will be some reworking of the administration's proposal, and I think you have raised several issues that need further consideration and further comment.

I apologize for being interrupted as we have been here today, and we appreciate your taking the time to come and present your testimony.

Mr. ECKSTEIN. As a veteran of such hearings, I understand the exigencies of congressional testimony; and if I did not believe that in the long run my testimony had an impact on reality, I would not accept your invitation. Thank you.

Senator NELSON. Thank you very much.

[The prepared statement of Mr. Eckstein follows. Oral testimony continues on p. 257.]

STATEMENT OF OTTO ECKSTEIN, PRESIDENT, DATA RESOURCES, INC., AND PAUL M. WARBURG PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

The nation's Social Security system has been one of the most successful government undertakings in our history. In its first 40 years, it has provided at least partial economic security for virtually our entire older population, most of the disabled and blind, and for the widows and children of deceased breadwinners. More recently, the Social Security system has been asked to manage our system of public medical insurance for the aged and disabled, and to administer a substantial portion of our welfare system.

The traditional portions of the Social Security system are financed through earmarked payroll taxes on employers and employees. The funds have been kept segregated, thereby insulating the benefits from the usual budget pressures and uncertainties. Automatic revenue growth helped assure growing benefits.

The process of increasing and extending the benefits of the Social Security system has been an elaborate ritual. Every four years, the Secretary of Health, Education and Welfare appoints an independent Social Security Advisory Council consisting principally of representatives of the pressure groups that support the system as well as experts who are close to and sympathetic to it. The Councils have recommended various extensions of coverage and benefit improvements, and have recommended the necessary increases in the payroll tax rates. These recommendations have been reviewed and modified by succeeding Administrations, and recommended to the Congress. The Congressional committees dealing with Social Security have been sympathetic and have enacted a large portion of the recommended benefit improvements. The result has been the growth of an enormous system that, on the whole, works very well, and has done far more to reduce need and poverty in the United States than all other programs combined. These who have played a significant role in the development of the Social Security system can take pride in the accomplishment.

But this happy period of the Social Security system is over. Like numerous other institutions, the recent economic crisis accelerated the day of financial reckoning. Inherent flaws that had previously been overcome by sheer size and growth have become more important. Today, there are just too many people eligible for coverage. Automatic increases of the system are too large. The benefit structure to too casual. And the administration of the system is in need of repair.

Unfortunately, there is little sign of internal self-renewal. This Administration mainly proposes, as every previous administration and Advisory Council did, that revenues be increased, without a serious look at the benefit problems. In the past, such revenue-increasing proposals fell well within the bounds of political acceptability: another tenth or two on the employer and employee tax rate now, and further increases in the more distant schedule, used to be sufficient to keep the system whole. But in the last decade, dramatic increases in the taxable earnings base became necessary, and when benefits were escalated, the earnings ceiling had to be escalated as well. The recession and cost overruns

have now produced a revenue shortfall which is too great for such measures to be sufficient. The Department of Health, Education, and Welfare and the President therefore had the choice of re-examining benefits or of finding a major new tax source for the system. They proposed a major new revenue source: a payroll tax on executive and professional salaries to be levied beyond traditional earnings ceilings, breaking the already slender tie between contributions and benefits.

This approach, if adopted, will not work for long. Somewhere in the 1980s, the government will be looking for another major new revenue source or a large increase in the tax rate of the new professional and executive salary tax. The reason is simple: without benefit and administrative reforms, expenditures will rise faster than the current projections.

The search for revenue has traditionally been couched in terms of the need to preserve the actuarial soundness. In the minds of the public, the Social Security system is still mainly a retirement pension system, with payments paid out to workers who have contributed over their lifetime. The President's proposals are explained almost entirely in these terms, lumping all aspects of OASDI programs together.

But the problems of the system are not in the traditional pension benefits to be paid to workers with a lifetime history of contributions. The problems arise in other places. Let me discuss three major problems which must be dealt with if social security is to continue to be a strong, viable program for the broad middle-class of working Americans.

(1) *Loosened eligibility standards for the Disability Fund.*—The Disability Fund will be out of money by 1978 or 1979 because its deficits are now reaching 20 percent of outlays. The rate of increase of spending of the disability fund over the last five years is an enormous 21 percent a year, and the report of the Board of Trustees of the Social Security funds projects a rate of increase of over 13 percent for the next five years. Total beneficiaries at the end of fiscal 1976 equalled 4,533,000 persons making this perhaps the largest redistributive social program in the U.S. Both recent experience and future estimates are substantially higher than had been expected earlier. According to the latest Trustee Report, the cost of the program, measured as a percentage of taxable payroll, would rise by 82 percent between 1977 and 2001, whereas the Old Age and Survivors Program would rise by just 11 percent. The number of beneficiaries would exceed ten million, a striking figure considering the improving health care for the American people.

TABLE 1.—TOTAL OUTLAYS AND TOTAL INCOME OF THE OLD AGE AND SURVIVORS INSURANCE FUND AND THE DISABILITY INSURANCE FUND: HISTORY AND CURRENT LAW PROJECTIONS

[In billions of dollars]

	Old age and survivors insurance fund		Disability insurance fund	
	Total outlays	Total income	Total outlays	Total income
History:				
1960	11.2	11.4	0.6	1.1
1965	17.5	16.6	1.7	1.2
1970	29.8	32.2	3.3	4.8
1971	34.5	35.9	4.0	5.0
1972	38.5	40.0	4.8	5.6
1973	47.2	48.3	6.0	6.4
1974	53.4	54.7	7.2	7.4
1975	60.4	69.6	8.8	8.0
1976	67.9	66.3	10.4	8.8
Projections:				
1977	75.7	72.5	12.1	9.6
1978	83.9	79.3	13.6	10.3
1979	92.1	87.7	15.4	11.3
1980	100.6	96.1	17.4	12.7
1981	109.4	102.8	19.5	14.6

There are many reasons for the past and projected explosion of the Disability Fund. Statutory eligibility was broadened repeatedly after 1960. What started out in 1956 as a requirement of permanent disability with a one-year waiting period, is defined today as a one year disability with a five-month waiting period.

Further, general liberalizations for Social Security, particularly raising the maximum age of child beneficiaries from age 18 to age 22 if they remain in school and the inclusion of grandchildren under eligibility, has meant that the disability program now includes a larger number of young individuals. Further, in earlier years the largest part of all beneficiaries consisted of individuals suffering from degenerative diseases of aging, who could be expected to spend only a relatively few years on disability before becoming eligible for the old-age programs. The program now includes increasing numbers of younger individuals, some of whom will stay on the program for as much as four decades. About one-third of young beneficiaries are suffering from mental disabilities that make them unable to hold a job, but which are tougher to evaluate than the traditional cases. This increase in younger workers is partly due to the short work experience that is necessary to become eligible.

Benefits have improved greatly, raising the incentives to become eligible. Cash benefit levels were raised 82 percent between December 1969 and December 1975, and in 1973 medical benefits became available to beneficiaries, The administration of the program also seems to have deteriorated. A recent study by the Department of Health, Education and Welfare analyzes termination rates of benefits due to recovery.[1] In 1967, 3.21 percent of all beneficiaries recovered from disability and ceased receiving benefits. By 1975, only 1.07 percent were terminated due to recovery.

The deficits of the Disability Insurance Fund represent nearly one-half of the deficits of the two trust funds which are lumped together in the Administration proposals. Therefore, the surprisingly drastic nature of the Administration's proposals to restore Social Security to a sound financial basis is attributable to the decision to let the Disability Fund continue along its path of rapidly rising outlays without administrative reform, and to seek its future financing under the name of soundness for the Social Security System as a whole.

In truth, the Disability Fund bears much less resemblance to an insurance system than the Old Age and Survivors Fund. The potential beneficiary group pays a small proportion of the future benefits; the redistributive element of this system is much greater than in the system as a whole. And now that the administration of the program has become looser, it is difficult to distinguish it from the regular welfare programs.

In part, the recession has also boosted the disability rates. An unemployed person is more likely to seek disability status to join the program. He may also become more prone to mental disability. Medical criteria are likely to be eased during high unemployment: where workers really have no chance of reemployment, the medical boards may be more sympathetic since the work alternative may be unrealistic. But the loosened eligibility standards are probably also a part of a general change in attitudes in the society.

(2) *Membership in Multiple Public Retirement Plans.*—The lack of universal coverage of social security and the existence of several separate public retirement systems has produced increasing abuses and burdened the Social Security system with ill-founded benefit costs. There are 8½ million public employees, including 2½ million Federal employees, who will be eligible for social security benefits even though they will have contributed very little to the system. The retirement programs of the Federal government and of state and local governments are already generous, generally more so than the retirement programs of even the most progressive employers. Retirement ages are exceptionally early. Such public workers increasingly become covered in the Social Security system by part-time work under multiple job holdings, or by some years of private employment following their civil service retirements. Given the redistributive, progressive structure of social security benefits, and given the relatively brief work experience that is required, even now, to become eligible, the benefits that public employees can receive from social security are very large in relation to their contributions. This problem has been compounded further by the recent Supreme Court decision to reduce some sexist discriminatory elements. All of a sudden, a civil service husband married to a wife working in the private sector becomes entitled to increased social security benefits without contributing.

[1] *Experience of Disabled-Worker Benefits Under OASDI, 1965–74.* U.S. Department of Health, Education, and Welfare, Social Security Administration, Actuarial Study No. 74, January, 1977.

The generous treatment of public employees was a luxury that the system could afford in its heyday. But the costs are mounting as benefits are becoming more generous and the number of public employees reaching retirement age expands greatly. The answer to this problem has long been clear, and was recommended in the most recent Advisory Council report: some form of integration of the public retirement programs with social security. The Council recommended compulsory universal coverage—which would produce a near-term revenue windfall and a heavy burden to public budgets. There are lower-cost alternatives. But some solutions must be found. The present system is one of those untouchable "sacred cows" that we just cannot afford anymore if the system is to perform its primary mission.

(3) *The Minimum Benefit.*—The minimum benefit level for social security has lost its rationale. As the last Advisory Council reported, the minimum benefit levels are collected principally by individuals with a brief contribution period, such as public employees and foreign workers. A worker earning the Federal minimum wage for a normal work life would receive almost twice the minimum benefit.

One of the principles of the President's proposals is the retention of a constant replacement ratio, that is a constant ratio of retirement benefits in relation to earned pre-retirement income. This is a sound principal although ambiguous in interpretation. The system should be moved closer to an earnings-related pension system—leaving the other programs, such as SSI, the task of providing minimum income support for those with an inadequate earnings record. The most recent Advisory Council report sketched out a method which would gradually disengage the system from the present formula without causing serious inequities. A more fundamental way to escape current anomalies is to move more quickly toward a longer required work record and a change in the contribution-benefits relationship toward proportionality. These matters are discussed more fully in the excellent volume by Alicia Munnell, *The Future of Social Security*, Brookings, 1977.

The President's Proposals

It is of paramount importance to assure future beneficiaries of the pension programs that the Social Security system will be able to pay their entitlements. Consequently, it is necessary to enact major proposals to produce extra revenues, if only because reforms on the benefit side will take time. The new quadrenial Advisory Council is just now beginning to be formed, and its recommendations are hardly likely to become effective before 1980. In the meantime, major remedial steps must be undertaken. Let me comment on the major proposals.

(1) *General revenue sharing to make up the recession shortfalls.*—In my testimony to the Senate Budget Committee on March 2, 1976, I proposed a one-time transter of general revenues of \$5½ billion to compensate the trust funds for the lost revenues caused by the underemployment during the recession. The Administration has now generalized these plans to larger magnitudes, a total of \$14.1 billion to be transferred in the years 1978–80. While I see no reason to delay the timing of the transfer, I strongly endorse these proposals.

I recognize that general revenue financing is a deep, philosophical issue, stirring fears that the discipline of the payroll taxes will be lost as a result. Nonetheless, I urge you strongly to look at this proposal with an open mind because it really has exceptional merit.

First, as I argued above, the discipline on spending is illusory. The system by which social security expenditure policy is determined is inadequate under the present set-up, and has produced excessive costs. The tax increases that are now required, even with the general revenue sharing contribution, are very large, necessitating a major new revenue source, which in fact is indistinguishable from general revenue sharing except in name—a general tax on employer payrolls which will produce no benefits. Thus, if the discipline argument against general revenue contributions ever had a merit, it was lost somewhere along the way.

Second, the one-time general revenue transfer would strengthen the trust funds without imposing an excessive fiscal drag on the economic recovery. To bring the trust funds up by many billions of dollars is impossible, even with the very ambitious tax proposals before us. The one-time infusion of general revenue money, justified by the misfortunes of 1973–75 which surely cannot be

blamed on the social security funds, would reduce the need for tax increases and would, on the Administration's interpretation, provide a rationale for not inrceasing the trust funds dramatically in the future. Furthermore, this rationale is realistic: if there really were a prolonged economic crisis or a major change in the economic system, the trust funds would be depleted in a few months anyway. The security of the pension payments is, in fact, based on the moral guarantees by the U.S. Treasury, and on nothing else.

Third, when I proposed the one-time transfer a year ago, I partly did so in order to make it possible to defer more basic decisions to a post-election Congress. I now discover that the new Administration can face up to the revenue side in a hurry, but that expenditure reform is a much slower undertaking. Consequently, the transfer of general revenue funds is necessary once more to buy time for the bigger decisions which will ultimately be inescapable.

Finally, the one-time transfer does not freeze us into a new policy on the use of general revenues. It really is an open question whether the permanent use of general revenues is wise. Once that step is taken, the logic of segregating the Social Security system from the rest of the budget is gone. I recognize that there have been various limited uses of general revenues in the past but they have been for relatively narrow purposes.

(2) *Taxing employers on the entire earnings of employees by 1981.*—Although this tax will be very burdensome on such organizations as universities, law firms and consulting firms, I find that the more I consider the tax the more merit I can find in it. For one thing, it has some incidental benefits in reducing some tax loopholes such as the incorporation of professional practice. Further, those corporations which find themselves able to pay enormous corporate salaries can presumably also afford to pay the tax of 6.30 percent that would be imposed. Against these considerations must be weighed the increasing payroll tax burden of business to restore the unemployment insurance trust funds and the legislated and proposed routine increases in the tax base.

But the bigger question raised by the new tax on professional and executive salaries relates to the Social Security system itself. Should the system be given access to this massive new revenue base before the tougher decisions on reforming expenditures have been made? Experience suggests that the expenditure reforms are not likely to be made if the revenues are provided to muddle on without reform. I therefore urge you to delay the imposition of the new tax until after the decisions on the expenditure side have been made. In the interim, if it should prove necessary, the system can be kept whole by the more traditional kind of increases in the tax base and by the infusion of general revenues.

(3) *Correcting over-indexing.*—There is no question that the Congress will have to correct the over-indexing which was inadvertently written into the law in 1972; the only questions are how and when. I have not made a detailed study of the various methods of solving the problem. At the level of principle, I endorse the findings of the consultants report to the House Ways and Means Committee. This report favors a thorough price indexing of the contributions during the earnings-averaging period and a progressive lengthening of the averaging period, thereby greatly increasing the real relationship between benefits and contributions. This formula, taken in isolation, would imply a falling replacement ratio. But any savings realized from this approach could easily be devoted to more selective benefit improvements.

ECONOMIC EFFECTS OF THE ADMINISTRATION PROPOSALS

DRI has assessed the economic impact of the Carter proposals, using its 900-equation econometric model of the U.S. economy. New tax collections begin in 1979, when the employer and employee base changes are projected to go into effect. As approximately $5 billion of improvement in the Social Security system for 1980 has already been reflected in our previous forecasts, the proposals add only $5.6 billion in additional fiscal restraint.

Results show that the program will have a small but significant negative effect on overall economic performance, slowing real final demand and increasing inflationary pressures. The large increase of employer taxes raises total compensation by 0.4 percent in 1980, and by 0.6 percent thereafter. These costs will largely be shifted into higher prices. Feedback effects boost the total inflationary impact to 0.5 percent in 1980.

Real GNP is lower by 0.4 percent in 1980. These comparisons relate to the DRI baseline forecast which already assumed more limited Social Security changes.

TABLE 2.—IMPACT OF THE SOCIAL SECURITY FINANCIAL PROPOSALS THROUGH 1980

	1979	1980
Percent difference in level:		
Real GNP	-0.2	-0.4
Real consumer spending	-.2	-.4
Real business fixed investment	-.1	-.2
Real disposable income	-.3	-.7
Real after tax profits	-.7	-.9
Compensation per man-hour	.3	.5
Consumer Price Index	.2	4
Implicit price deflator	.2	.5
Wholesale Price Index	.2	.5
Difference in level (thousands):		
Automobile sales	-100.0	-200.0
Housing starts	-9.0	-18.0
Difference in rate: Unemployment rate		.1
Difference in level (billions, fiscal year): Federal Government deficit decrease	$2.6	$5.3

The net impact of the higher taxes is to lower private spending. Consumption is cut 0.4 percent in 1980 by lower incomes and higher prices. All final demand components reflect marginal losses: beforetax profits are lower by $2.1 billion in 1980, or about half the increased employer burden, reducing the profit share of GNP from 8.7 percent to 8.6 percent. Real investment is cut by 0.2 percent because of lower profitability and higher interest rates.

THE CONGRESSIONAL CHALLENGE

Revamping of the Social Security financing system is a complex issue and will undoubtedly meet with a wide range of political sensitivities. Congress will want to consider many of the issues in detail, along with various alternative plans. In particular, the Congress may wish to give serious attention to the specific problems of the Disability Insurance Fund. Without such attention, any solution on the revenue side will be temporary, and will have to be followed by legislative patching in future years as costs keep spiraling.

The Social Security system has reached a crucial decision point at an awkward moment. Large deficits are coming at a time when the expenditure side of the system is not under study. Yet it would be unwise to attempt to permanently solve the system's financial problems entirely by turning over to it a virtually unlimited revenue base. The new tax that has been proposed, a tax on professional and executive salaries, would make it possible for the system to go on for many years without facing up to the very serious flaws that have crept into the expenditure side. My recommendation to the Congress is to find temporary financial solutions, to speed up the process by which expenditure reform can be achieved, and then to enact the proposed new employer tax if it is still needed.

Senator NELSON. The next hearing will be at 9 a.m., July 15.

[Whereupon, at 12:35 p.m., the subcommittee was adjourned, to reconvene on Friday, July 15, 1977, at 9 a.m.]

SOCIAL SECURITY FINANCING PROPOSALS

FRIDAY, JULY 15, 1977

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:10 a.m. in room 2221, Dirksen Senate Office Building, Hon. Gaylord Nelson (chairman of the subcommittee) presiding.

Present: Senators Long, Nelson, and Packwood.

Senator LONG. I am going to call this hearing to order. I am going to ask that we wait until Senator Nelson is here to hear the witness from Milwaukee County, Wis.

I suggest that we call the panel representing the U.S. Chamber of Commerce, the National Association of Manufacturers, the Business Roundtable, and the Council of State Chambers of Commerce.

We are very pleased to have all of you here, gentlemen. First, I would like to ask that all the statements be printed in the record. Then we will have you summarize your presentation.

After that, we hope to ask you some questions. Just for fear that we might run into the hour when the Senate has not given us permission to meet, I ask that all of the statements be printed in the record, and we will proceed with each of you summarizing your statements.

STATEMENT OF JOHN R. WALL, VICE PRESIDENT OF PERSONNEL, REPUBLIC STEEL, ACCOMPANIED BY STAN KING, ASSISTANT VICE PRESIDENT FOR AMERICAN TELEPHONE & TELEGRAPH; AND PRESTON BASSETT, VICE PRESIDENT AND ACTUARY FOR TOWERS, PERRIN, FORSTER & CROSBY

Mr. WALL. My name is John R. Wall. I am vice president for personnel of Republic Steel. I am accompanied by Stanley L. King, who is assistant vice president for American Telephone & Telegraph; and Preston C. Bassett, who is vice president and actuary for Towers, Perrin, Forster & Crosby, Inc., an organization of consultants to management, specializing in employee benefits and actuarial services.

We appear today at the invitation of the subcommittee on behalf of several business organizations. Together, these organizations represent a broad cross-section of the American business community.

Mr. Chairman, we applaud your efforts and that of President Carter in placing social security financing among your top priorities. There are few problems of greater concern to the American public

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than the resolution of the social security financing crisis. We wholeheartedly endorse the recommendations of the administration and the Board of Trustees for the social security system that Congress must act this year to resolve the growing crisis. Of the eight specific proposals advanced by the Carter administration, we substantially concur in three: decoupling, revising the dependency test, and raising the tax upon the self-employed. We oppose the remaining five, and I want to interject at this point that we are opposed to any suggestion to use general revenues or otherwise depart from tested modes of financing the system.

Senator LONG. If I may interrupt you, I am against this same thing, but that's not the way I regard it. I do not regard it as using general revenues, but I regard it as using printing press money. There are no general revenues to finance it with. The General Fund is in the red by $60 billion.

All you can do is just print money down at the Federal Reserve and haul it up here, or put it on a computer down there. You and I know that will not work.

Mr. WALL. I agree with you, Mr. Chairman.

The problem we face today is twofold. We must first overcome the short-term deficit that, unless corrected, will result in the unthinkable prospect of social security not being able to issue its benefit checks, particularly to disability claimants where the funds are almost gone and the need in many cases is great. The fuse on this problem is extremely short, and the disability insurance trust fund could exhaust late next year.

The second problem to be tackled is long range, and it is caused largely by demographic trends and a faulty benefit formula. Each year we delay in resolving this crisis makes the solution that much more painful and difficult.

The business community joins the rest of the Nation in wanting a soundly financed social security program. It is in our interest and that of our employees and their dependents to assure the financial integrity of this program.

Since the business community underwrites almost one-half of the cost of this program and since vast sums of money, at least $70 billion in added revenues, will be needed in OASDI funds between now and 1982, a great deal of attention has been devoted to devising an appropriate solution.

Our organizations recently pooled their expertise to develop a comprehensive solution that would be economically supportable and publicly acceptable. We believe that we have that solution, and we are pleased to share it with you.

Our comprehensive proposal solves the short-term deficit as well as substantially decreasing the long-range deficit. It deals with the pressing need to revise the program's financing as well as its benefit structure. Moreover, it offers a plan that, unlike other proposals, relies upon tested methods of keeping social security on a sound basis.

Our recommendation calls for Congress to act this year, 1977, on three features of the law.

First: Congress should approve an increase in the tax rate of not less than three-tenths of 1 percent on employers and employees, to become effective on January 1, 1978.

Second: Congress should reestablish the OASDI tax rate on the self-employed at the traditional level of 1½ times the tax rate levied on employees.

Third: Congress should modify the social security benefit computation formula to eliminate the inadvertent overadjustment for inflation that has been in effect since 1972 for determining the initial benefit claims of future retirees. This modification, known as decoupling, should be accomplished by adopting a wage-indexed benefit formula that would restore future benefits to the wage replacement ratios in effect prior to the adoption of the flawed 1972 benefit formula.

In retrospect, it is clear that the 94th Congress acted wisely in not increasing OASDI taxes. Such an increase in either 1975 or 1977 when the economy was beginning its recovery would have been counterproductive. At that time, we had sizable social security trust funds which could, and did, absorb the excess of outgo over income.

This demonstrates the importance of having adequate trust fund balances.

Today, the situation is different. The economy is inherently strong and can absorb a modest payroll tax increase.

There is universal agreement that there are only three general methods of increasing revenue into the social security trust funds. These are:

One: An increase in the taxable earnings base;

Two: An increase in the tax rates; and

Three: The introduction of monies into the system from sources other than payroll taxes, the most likely source being general revenues.

Arguing on behalf of a tax rate increase is not an enjoyable undertaking. Nobody wants to pay more taxes—employers included.

At issue is not whether we increase social security revenues, but how they are to be raised and who will pay the added taxes.

Various combinations of the three methods are possible, but we have concluded that the optimum solution is to raise the tax rate for employers, employees, and the self-employed.

In arriving at our position, we considered other proposals, but rejected them in favor of a modest tax rate increase.

We recommend a three-tenths of 1 percent increase in the OASDI tax rate so that all who contribute to social security will share equally in the added tax. This is the most responsible course of action, in our opinion.

If Congress adopts our recommendations, the social security program will, over the next 10 years, meet its self-imposed standard; disbursements should about equal revenues.

Instead of a projected deficit in the combined trust funds of $174 billion, these modest steps will result in a $32 billion positive balance.

As a result, neither the disability insurance trust fund nor the old age and survivors insurance trust fund will be exhausted. Moreover, Congress would then have ample time to thoroughly review the social security program and to consider more fundamental revisions.

Exhibits 5 and 6 on page 9 of our testimony illustrate the impact of our recommendations and compares these with current law and the administration's proposals.

A tax increase is a visible and constructive response to the short-term financing crisis. People will know what they are paying for and have renewed confidence in OASDI's future.

We believe that it is also important to stress the desirability of maintaining a tax rate structure that treats employers and employees equally while requiring the self-employed to contribute taxes at a level 1½ times that of the contributions of other covered workers.

This, too, will help to insure continued public support for social security.

Raising the tax rate is sometimes unjustly criticized as a regressive step, but this point fails to take into account the highly progressive nature of social security benefits.

Increasing payroll taxes is also said to have an employment disincentive effect. However, our proposal will produce less than a $1 per week tax increase for most workers.

If there is concern about the effect that the cumulative tax increase on employers would have on employment, Congress could offset this OASDI payroll tax increase with a decrease in the unemployment insurance tax rate as suggested by the Chamber to this committee earlier this year in testimony on H.R. 4800 and S. 604.

An alternative to the tax rate increase would be an increase in the taxable earnings base. The administration has proposed this approach.

Under the administration's proposal, the cap would be removed only on the wage base to which the employer's share of the social security tax is applied.

The base would rise in stages for employers to the entire amount of the employee's wage by 1981.

The purpose of this separation is to raise tax revenues without at the same time raising future benefit entitlements, since entitlements are keyed only to the earnings on which employees pay taxes.

We cannot support this alternative. The administration's proposals are more symbolic than substantive. Employees do not go unscathed when taxes are imposed on employers. Business must pass on these costs. The public ultimately foots the bill.

The administration has also proposed to use general funds to make up for the lost revenues caused by the high levels of unemployment in recent years.

The use of general revenues to help finance social security benefits will not restore financial soundness to the system; it will have just the opposite effect. Borrowing from one deficit to cover another deficit can hardly be described as a solution. Nor can it be dismissed as a mere juggling of figures on the books.

Looked at honestly, it will involve either higher taxes, increasing the public debt or cutting expenditures elsewhere.

Moreover, the introduction of general taxpayer subsidies would destroy the "earned benefit concept" of social security since benefits would no longer be tied to contributions by workers and their employers.

With general taxpayer subsidies, benefits would increasingly be subjected to the "needs considerations" typical of welfare programs.

We doubt that American workers want a welfare retirement program.

Now, let's talk about decoupling.

Increasing social security revenues via a tax rate increase as we suggest will solve the short-term financing problems and help toward meeting the long-range deficit as well. But solving the long-range deficit will require something more than moderate increases in social security taxes.

Unless something is done to correct the overadjustment for inflation that is now occurring with respect to initial benefit computations, future workers and their employers will face the prospect of a 30-percent OASDI payroll tax, or about three times the combined tax paid by current workers and employees.

There is a near-unanimous agreement on how to avert this result. This is "decoupling."

We recommend that the present "coupled" benefit structure be "decoupled" in a way that would stabilize replacement rates at roughly pre-1972 levels.

We support the decoupling proposal advanced by the American Council of Life Insurance which also includes a transition period to protect workers who are about to retire.

Our organizations are in agreement that there is an urgent need to act this year on decoupling. Any further delay will result in additional double indexing.

We thank you for this opportunity to testify and we would welcome any questions you might have about our recommendations.

Senator LONG. I think that you have made a very good statement here. It deserves the careful attention of the committee, and I will see that it gets that study.

I would like to ask you a little about how you think that the tax should go on. Do you agree with this administration's recommendation that the tax should be extended to cover all payroll as far as the employer is concerned?

Mr. BASSETT. No, we are opposed to that. As a matter of fact, we are very much strongly in support of the present system which has been in effect for some 40 years and has done, we think, an outstanding job—that is, equal taxes by both employee and employer.

We feel that once you break from this tradition, we are opening up the social security system to what we would term as abuses by benefits getting out of hand.

If you once move away from equal employer-employer taxes, there is nothing to say that the tax rate on employers cannot be increased. Really, from the point of view even of Congress, I think Congress needs the protection, you might say, of being able to say we cannot increase benefits, as much as you would like to increase social security benefits, we cannot do it because we have to provide for the taxes and put them on an equal basis.

Once these restrictions are removed, there is no limit to how high social security benefits might go. We think it is important that they retain social security as a basic form of protection and not cut into the private pensions.

Senator LONG. Senator Curtis would like to know if you have any suggestions how you might cut expenditures, other than the decoupling proposal.

Mr. KING. We are concerned about both the short- and long-term problems that we are faced with in this country, and one of the problems that we have with the administration's proposal is that it does, it seems to us, move very quickly in an effort to solve most of these problems and does indeed, despite what the administration has stated, increase expenses considerably.

We feel that our solution will help Congress and the country in dealing with the short-term problem, and permit time to get at the question of an appropriate level of benefits in the long term and a better method of financing, or some way to put this in balance with other problems that we have in this country.

We feel more time is needed to get at the problems and the question that Senator Curtis has asked.

Senator LONG. I know one thing we ought to be looking at—the SSI disability program. When the program was about to go into effect up in New York, they took all of these welfare mothers who did not have any claim to any kind of disability, perhaps they had a little bit of hypertension, nervousness, almost everything, and they declared them to be disabled and loaded on the Federal Government to relieve the State of any burden of helping those people under their welfare program.

Because New York was in very difficult financial straits, we did not challenge that, but that was loading many millions of dollars on the Federal Government to pay people who were not really disabled at all.

We have a good rehabilitation program. We could work out a way to get the employers to hire more partially disabled people. We can help the program in that respect. I am sure that there are other ways that it could be done.

In other words, there are a lot of people who today are supposed to be disabled. Perhaps some of them are drawing reasonably good wages even though they get disability benefits and say they cannot do the work.

On behalf of Senator Curtis, I would like to ask why you think it is important to set replacement rates over the pre-1972 levels.

Mr. BASSETT. We feel that the social security benefits should be kept at what we feel is a floor of protection. Congress, when it amended the Social Security Act, effective in 1972, assumed that under reasonable economic conditions that the adjustment formula that they adopted would continue the same replacement ratios as were in effect in 1972. Unfortunately, we had higher inflation than anticipated. Conditions did not come to pass as was expected. Therefore, the replacement ratios have gone above the level that was intended when the act was passed in 1972.

We believe that if replacement ratios are to be increased, they should not be increased because of the effect of the economy, but because Congress and the people think they should be increased. Therefore, we think they should be returned to the levels that Congress set back in 1972.

Senator Long. Thank you very much, gentlemen.

[The prepared statement of the preceding panel follows. Oral testimony continues on p. 275.]

Statement of Chamber of Commerce of the United States, Business Roundtable, Council of State Chambers of Commerce, and the National Association of Manufacturers, by John R. Wall, Stanley L. King and Preston R. Bassett

My name is John R. Wall. I am vice president, Personnel of Republic Steel Corporation. I am accompanied by Stanley L. King who is assistant vice president for American Telephone & Telegraph Company and Preston C. Bassett who is vice president and Actuary for Towers, Perrin, Forster & Crosby, Inc., an organization of consultants to management specializing in employee benefits and actuarial services.

We appear today at the invitation of the Subcommittee in behalf of four business organizations which share a common view about how to remedy the financial plight of our nation's social security system. These organizations are:

(1) Chamber of Commerce of the United States which represents over 65,000 business firms across the United States, as well as 2,600 local, state and regional chambers of commerce and 1,100 trade and professional asociation.

(2) Business Roundtable, an organization of 100 of our nation's largest corporations;

(3) Council of State Chambers of Commerce which represents 32 state business organizations; and,

(4) National Association of Manufacturers which represents approximately 13,000 firms.

THE SOCIAL SECURITY CRISIS

We sincerely appreciate the opportunity to share with you our assessment of the financial crisis confronting the Social Security system and our recommendations for resolving both the short-term and long-range financing problems.

Mr. Chairman, we applaud the efforts of the Carter Administration in placing this issue among its top priorities. We concur in the recommendation of the Administration and the Trustees of the Social Security Trust Funds that Congress must act this year to resolve the growing crisis.

It is unthinkable that the Social Security program would be unable to meet its commitments. Yet, the program is in trouble. In 1975 and 1976, the system paid out $4.8 billion more than it took in from payroll taxes from employers, employees and the self-employed. These deficits are expected to reach $5.6 billion this year and $6.9 billion in 1978. Although Social Security is a pay-as-you-go system in which payout is expected to approximately equal income, deficit spending is made possible by relying upon modest surpluses in the trust funds. In light of recessionary conditions during 1975–76 this was an appropriate use of the trust funds. However, with the economy improving and trust fund balances diminishing we must not and cannot continue this practice.

As described by the Trustees in their annual report for 1977, expenditures are projected to exceed income in 1977 (as was the case in 1975 and 1976) and each year thereafter. Unless legislation is enacted to provide additional revenues, the disability insurance trust (DI) will be exhausted in 1979, the old-age and survivors insurance (OASDI) trust fund in 1983 and the hospital insurance (HI) trust fund in the late 1980s'. Should the economy turn downward, these projected insolvencies will be upon us much sooner. (See exhibit 1.)

While several factors have combined to produce the short-term problem, high levels of inflation and unemployment have combined to increase benefits and cut tax collections.

In the long-range, outlays from OASDI trust funds are estimated to exceed income in every calendar year from 1977 to 2051. Under an intermediate set of economic assumptions, the Trustees project that the annual deficit will average about 8.2 percent of taxable earnings over the entire 75-year period. (See exhibit 2.) This is equivalent to an annual deficit of $66 billion if based on the 1977 taxable payroll.

This long-term revenue crisis is primarily due to a combination of inflation, demographic changes and basic weaknesses in the benefit computation procedures of the system.

(*a*) *Inflation.*—Since Congress amended the Social Security system in 1972, inflation and unemployment have increased beyond the expectations of most analysts, including the actuaries for the OASDI trust funds. As a consequence, the current long-range financing plan overestimated revenues and underestimated expenditures.

(*b*) *Demographic changes.*—Complicating the financial future even more is the fact that current demographic projections indicate a continuing low birthrate. This will mean that fewer persons can be expected to enter the workforce and pay the taxes to provide benefits for a growing retired population. Because of these trends, the number of social security beneficiaries for every hundred workers paying social security taxes will climb from about 30 per 100 this year to more than 50 per 100 by the middle of the 21st century. (See exhibit 3.)

(*c*) *Benefit weaknesses.*—A third source of the prospective deficit is found within the benefit structures of the system itself. A serious unwitting flaw in the 1972 amendments will very likely result in many future retirees drawing more in monthly benefits than their pre-retirement monthly wages. (See exhibit 4.)

EXHIBIT 1

SOCIAL SECURITY TRUST FUND RESERVES UNDER CURRENT LAW (COMBINED BASIS)

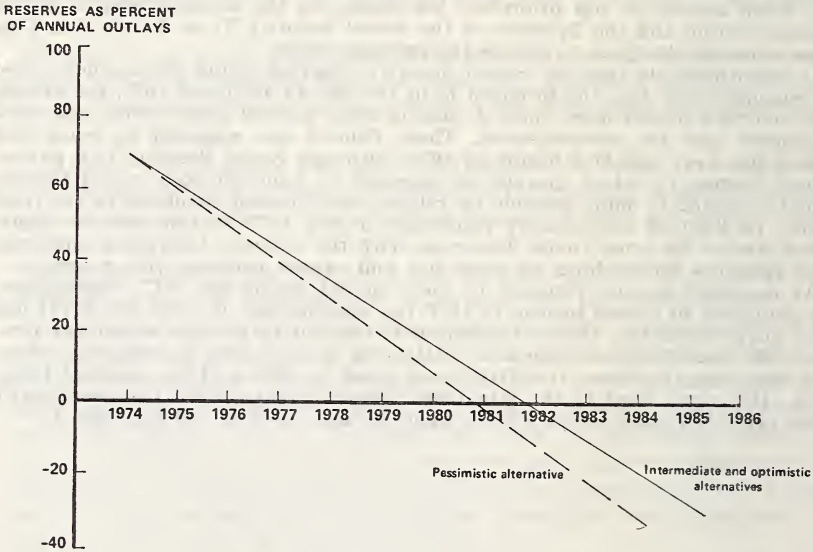


EXHIBIT 2

SOCIAL SECURITY CASH BENEFITS: COST AS A PERCENT OF PAYROLL

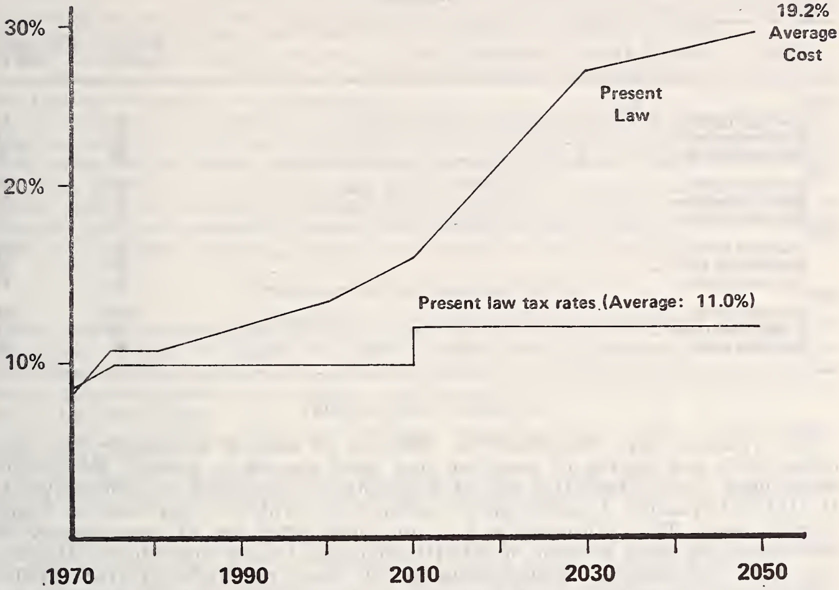


EXHIBIT 3

PROJECTED BENEFICIARIES PER HUNDRED COVERED WORKERS
1976-2050

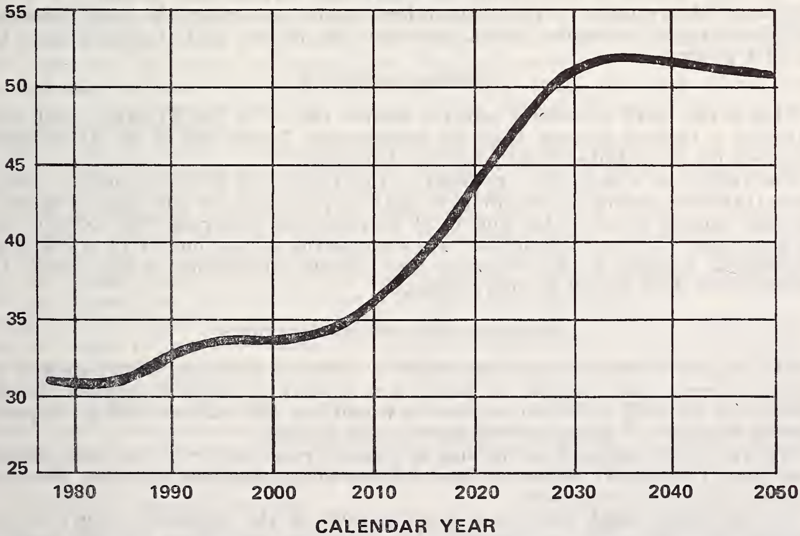


EXHIBIT 4

SOCIAL SECURITY BENEFITS UPON RETIREMENT AS A PERCENT OF EARNINGS IN THE YEAR BEFORE RETIREMENT: PRESENT LAW

[In percent]

	Without spouse	With spouse over 64
1977:		
Low-wage earner	58	88
Median-wage earner	46	69
High-wage earner	33	50
2000:		
Low-wage earner	75	113
Median-wage earner	53	80
High-wage earner	38	57
2025:		
Low-wage earner	94	141
Median-wage earner	63	95
High-wage earner	45	67
2050:		
Low-wage earner	106	159
Median-wage earner	70	104
High-wage earner	48	72

ECONOMIC ASSUMPTIONS

The Trustees have recognized the difficulty of making long-range cost estimates with any degree of precision and have elected to present projections based upon three alternative sets of assumptions, designated as alternatives I, II, III. Alternative I incorporates assumptions which would lead to lower OASDI costs. Thus Alternative I is an "optimistic" set of assumptions, at least from the point of view of OASDI financing. On the other hand, Alternative III's "pessimistic" assumptions would cause relatively greater OASDI expenditures, relative to tax income. An intermediate set of assumptions, designated Alternative II, is selected as a compromise projection of income and outgo which can be used as a basis for legislating program financing and as a yardstick against which to measure actual program experience as it develops.

While it may be reasonable to assume that actual experience will fall within the range defined by these alternatives, particularly during the first 25 years of the projection, there can be no assurance that this will be the case because of the high degree of uncertainty in long-range forecasting. Appendix I of our testimony shows some of the assumptions made concerning the basic economic and demographic variables which determine the income and expenditures of the OASDI program.

CONGRESS MUST ACT

This is the third successive adverse annual report by the Trustees, with each painting a bleaker picture than its predecessor. There can be no doubt about the need for immediate attention by the Congress.

The failure of Congress to respond to this crisis will heighten public concern over OASDI's ability to continue to play a vital role in our income security system. Indeed, some states and local governments believing that OASDI is a poor bargain for their employees, are considering opting out of it, while other employees, notably young workers, are having increasing doubts about the certainty of their Social Security benefits.

ADMINISTRATION RECOMMENDATIONS

The Carter Administration has urged a series of sweeping revisions and so-called reforms most notable of which are a hefty increase in payroll taxes—$35 billion by 1982 of which employers would pay $30 billion—and an unprecedented diversion of general revenues into the system.

We are firmly opposed to the use of general revenues or to any other departure from traditional modes of financing the Social Security program. We urge you to reject these proposals.

On the other hand, there are some aspects of the Administration's recommendations which we do support. For example, we agree on the need to decouple, revise the dependency test and raise the tax rate for the self-

employed although we would suggest some modifications to the Administration's proposals.

BUSINESS COMMUNITY RECOMMENDATIONS

Guranteeing the financial integrity of Social Security is among the highest priorities for our nation. At stake are the monthly benefits currently being paid to 33 million Americans and benefits for millions of future retirees.

The business community wants a soundly financed Social Security program. It is in our interest and that of our employees and their dependents to assure the financial integrity of this program.

Since the business community underwrites almost one-half of the cost of this program and since vast sums of money—at least $70 billion in added revenues—will be needed in OASDI funds between now and 1982, a great deal of attention has been devoted to devising an appropriate solution.

Our organizations recently pooled their expertise to develop a comprehensive solution that is economically supportable and publicly acceptable. We believe that we have that solution, and we are pleased to share it with you.

SUMMARY OF RECOMMENDATIONS

Our comprehensive proposal deals with the short-term deficit as well as the long-range deficit. It deals with the pressing need to revise the program's financing as well as its benefit structure. Moreover, it offers a plan, that, unlike other proposals, relies upon tested methods of keeping Social Security on a sound financial basis.

Our recommendation calls for Congress to act this year, 1977, on three features of the law.

First, Congress should approve an increase in the tax rate of not less than 0.3 percent each on employers and employees to become effective on January 1, 1978.

Second, Congress should reestablish the OASDI tax rate on the self-employed at the traditional level of 1½ times the tax rate levied on employees.

Third, Congress should modify the Social Security benefit computation formula to eliminate the inadvertent over-adjustment for inflation that has been in effect since 1972 for determining the initial benefit claims of future retirees. This modification, known as decoupling, should be accomplished by adopting a wage-indexed benefit formula that would restore future benefits to the wage replacement ratios in effect prior to the adoption of the flawed 1972 benefit formula.

INCREASED REVENUES

In retrospect, it is clear that the 94th Congress acted wisely in not increasing OASDI taxes. Such an increase in either 1975 or 1976 when the economy was beginning its recovery would have been counterproductive. At that time we had sizable Social Security trust funds which could, and did, absorb the excess of outgo over income. This demonstrates the importance of having adequate trust fund balances.

Today, the situation is different. The economy is inherently strong and can absorb a broadly distributed payroll tax increase without serious implications. The trust funds should now be restored to adequate balances.

There is universal agreement that there are only three general methods of increasing revenue into the Social Security trust funds. These are: (1) an increase in the taxable earnings base; (2) an increase in the tax rates; and (3) the introduction of monies into the system from sources other than Social Security taxes, the most likely source being general revenue.

Arguing on behalf of a tax rate increase is not an enjoyable undertaking. Nobody wants to pay more taxes—employers included. At issue is not whether we increase social security revenues, but how they are to be raised and who will pay the added taxes.

Various combinations of the three methods are possible, but we have concluded that the optimum solution is to raise the tax rate for employers, employees, and the self-employed. In arriving at our position, we considered other proposals but rejected them in favor of a modest tax rate increase.

1. Support for tax rate increase

We recommend a modest 0.3 percent increase in the OASDI tax rate so that all who contribute to Social Security will share equally in the added tax. This is the most responsible course of action.

If Congress adopts our recommendations, the Social Security program will, over the next 10 years, meet its self-imposed standard: Disbursements should about equal revenues. Instead of a projected deficit in the combined trust funds of $174 billion, these modest steps will result in a $32 billion positive balance. As a result, neither the disability insurance trust fund nor the old age and survivors insurance trust fund will be exhausted. Moreover, Congress would then have ample time to thoroughly review the Social Security program and to consider more fundamental revisions.

Exhibit 5 illustrates the impact of our recommendations and compares these with current law and the Administration's proposals. (See exhibit 5.)

EXHIBIT 5.—ESTIMATED OPERATIONS OF THE OASI AND DI TRUST FUNDS, COMBINED, DURING CALENDAR YEAR 1977–87 UNDER PRESENT LAW AND UNDER THE PROGRAM AS MODIFIED BY THE ADMINISTRATION'S PROPOSALS AND THE BUSINESS COMMUNITY PROPOSALS

[In billions of dollars]

	Income			Outgo			Net increase in funds		
	Present law	Administration proposal	Business proposal	Present law	Administration proposal	Business proposal [1]	Present law	Administration proposal	Business proposal
Calendar year:									
1977	82.1	82.1	82.1	87.7	87.7	87.7	−5.6	−5.6	−5.6
1978	90.7	98.0	96.3	97.5	97.4	97.4	−6.9	.6	−1.1
1979 [2]	99.5	108.5	106.4	107.4	107.1	107.0	−7.9	1.4	−.6
1980 [2]	108.9	121.3	116.9	118.0	117.4	116.3	−9.1	3.9	.6
1981 [2]	117.4	134.1	127.0	128.9	128.0	125.7	−11.5	6.1	1.3
1982 [2]	125.2	144.7	136.0	140.1	138.7	135.1	−14.9	6.0	.9
1983 [2]	132.9	155.1	145.5	152.1	149.9	144.7	−19.2	5.2	.8
1984 [2]	140.7	165.7	155.4	165.1	162.1	155.1	−24.4	3.6	.3
1985 [2]	148.4	184.8	165.7	179.2	175.4	166.3	−30.9	9.4	−.6
1986 [2]	156.2	198.3	176.3	194.4	189.4	178.2	−38.2	8.9	−1.9
1987 [2]	164.4	211.7	188.0	210.5	204.4	191.3	−46.2	7.2	−3.3

[1] Including the effect of the revised dependency test for auxiliary and survivor benefits as proposed by the administration.
[2] Because it is estimated that the DI trust fund will be exhausted in 1979 under present law, the figures for 1978–87 under present law are theoretical.

Exhibit 6 compares the trust fund balances under current law, the Administration's proposals and our proposals. (See Exhibit 6)

EXHIBIT 6

COMPARISON OF COMBINED OASDI TRUST FUND BALANCES UNDER PRESENT LAW, ADMINISTRATION'S AND BUSINESS PROPOSALS

[Dollar amounts in billions]

	Funds at end of year			Funds at beginning of year as a percentage of outgo during year		
	Present law	Administration proposal	Business proposal [4]	Present law	Administration proposal	Business proposal
Calendar year:						
1977	$35.5	$35.5	$35.5	47	47	47
1978	28.6	36.1	39.4	36	36	36
1979 [1]	20.7	37.6	33.8	27	34	32
1980 [1]	11.6	41.5	34.4	18	32	29
1981 [1]	.1	47.6	35.7	9	32	27
1982 [1]	−14.8	53.6	36.6	(2)	34	26
1983 [1]	−34.0	58.9	37.4	(3)	36	25
1984 [1]	−58.4	62.5	37.7	(3)	36	24
1985 [1]	−89.3	71.9	37.1	(3)	36	23
1986 [1]	−127.4	80.8	35.2	(3)	38	21
1987 [1]	−173.6	88.0	31.9	(3)	40	18

[1] Because it is estimated that the DI trust fund will be exhausted in 1979 under present law, the figures for 1979–87 under present law are theoretical.
[2] Less than 0.5 percent.
[3] Funds exhausted.
[4] Including the effect of the revised dependency test for auxiliary and survivor benefits as proposed by the administration.

A tax rate increase is a visible and constructive response to the short-term financing crisis. People will know what they are paying for and have renewed confidence in OASDI's future. We believe that it is also important to stress the desirability of maintaining a tax rate structure that treats employers and employees equally while requiring the self-employed to contribute taxes at a level 1½ times that of the contributions of other covered workers. This too will help to insure continued public support for Social Security.

Raising the tax rate is sometimes unjustly criticized as a regressive step, but this point fails to take into account the highly progressive nature of Social Security benefits. Increasing payroll taxes is also said to have an employment disincentive effect. However, our proposal will produce less than a $1 per week tax increase for most workers. If there is concern about the effect that the cumulative tax increase on employers would have on employment, Congress could offset this OASDI payroll tax increase with a decrease in the unemployment insurance tax rate as suggested by the Chamber to this Committee earlier this year in testimony on H.R. 4800 and S. 604.

2. Oppose earnings base increase

An alternative to the tax rate increase would be an increase in the taxable earnings base beyond the scheduled maxicum of $17,700 in 1978 and automatically adjust that amount thereafter. Variations of this suggestion include the Administration's proposal to remove the limit on the employer's taxable wage base while raising the employee base by only $2,400.

We cannot support this alternative. The maximum taxable earnings base should not be used as a convenient method to meet short-term financing problems.

Earnings base increases are not fully cost effective. First, very little revenue is gained. Second, as a result of the additional tax, high-wage employees are credited with additional benefits, turning short-term revenues gains into deficits in later years. Finally, increasing the taxable wage base results in narrowing the role of private retirement savings efforts. The threat such an increase poses to the long-range future of private pension systems, and hence to a major source of equity capital for American industry, is substantial.

Under the Administration's proposal, the cap would be removed only on the wage base to which the employer's share of the Social Security tax is applied. The base would rise in stages for employers to the entire amount of the employee's wage by 1981.

The purpose of this separation is to raise tax revenues without at the same time raising future benefit entitlements, since entitlements are keyed only to the earnings on which employees pay taxes. The rising cost of Social Security to employers reduces their contributions to private pension systems. It is not suggested that companies would actually scrap such systems, but the relative role of private pensions would be likely to diminish.

The Administration's proposals are more symbolic than substantive. Employees do not go unscathed when taxes are imposed on employers. Business must pass on these costs. The public ultimately foots the bill.

3. Opposition to use of general revenues

The Administration is caught in the bind between mounting trust fund deficits and the desire to fulfill President Carter's campaign promise to solve the crisis without raising the taxes paid by low and moderate income workers. Consequently, it has proposed to use general revenues to make up for the loss of revenues caused by the high-level of unemployment in recent years.

The use of general revenues to help finance Social Security benefits will not restore financial soundness to the system; it will have just the opposite effect. Borrowing from one deficit to cover another deficit can hardly be described as a solution. Nor can it be dismissed as a mere juggling of figures on the books. Looked at honestly, it will involve raising income taxes or increasing the public debt.

We note another deficiency in this proposal. According to testimony before this Subcommittee by HEW Secretary Califano, the Administration proposes to subsidize the Social Security trust funds to the extent necessary to replace the Social Security taxes that are lost when the unemployment rate exceeds 6 percent. The Secretary estimated that for the period 1975–78, this would involve $14.1 billion. The transfers would be made in 1978–80 in three annual installments of $6.5 billion, $4.3 billion and $3.3 billion.

This estimate was quetioned by Dr. Robert J. Myers, former chief actuary for the Social Security program and currently Professor of Actuarial Sciences at Temple University. In verifying the computations, Dr. Myers found that the government's methodology produced a result that was about three times higher than the actual experience in 1975 and 1976 produced. Dr. Myer's calculations are shown in exhibit 7.

EXHIBIT 7

ACCURACY OF ADMINISTRATION'S "UNEMPLOYMENT TAX LOSS" PROJECTIONS

[Dollar figures in millions]

	Calendar year—	
	1975	1976
1. Taxes estimated in 1974 trustees report	$66,084	$73,344
2. Actual taxes	$64,259	$7,595
3. Unemployment rate estimated in 1974 trustees report (percent)	5.8	4.9
4. Actual unemployment rate	8.5	7.7
5. "Tax loss" according to administration	$5,205	$6,014
6. "Tax loss" if structly proportional to unemployment	$1,735	$2,005
7. Actual "tax loss"	$1,825	$1,749

Irrespective of the mathematics of the general revenue subsidy, the critical concern must be with the proposed departures from traditional funding practices. In 1953, Congress adopted the principle of self-support for Social Security. Briefly, this principle meant that, over the long run, no general funds—no "needs test" money—would be used to pay for benefits. All costs would be met from payroll taxes levied on employers and employees and from interest credited to the trust fund.

Each time Congress liberalized the program—by increasing benefits, by making them easier to get, or by adding new kinds of benefits—taxes were raised enough so that projected income and benefit costs (including administrative expenses) would be about equal, over the long run. Moreover, when any "actuarial" deficits arose, Congress raised taxes enough to maintain the program on a self-supporting basis.

Success for this method of financing depends upon the willingness of today's and tomorrow's workers to pay the full cost of benefit commitments made by Congress. If Congress were to introduce general-revenue financing, we would no longer have this essential self-discipline. Moreover, the introduction of general taxpayer subsidies would destroy the "earned benefit concept" of Social Security since benefits would no longer be tied to contributions by workers and their employers. With general taxpayer subsidies, benefits would increasingly be subjected to the "needs considerations" typical of welfare programs. We doubt that American workers want a welfare retirement program.

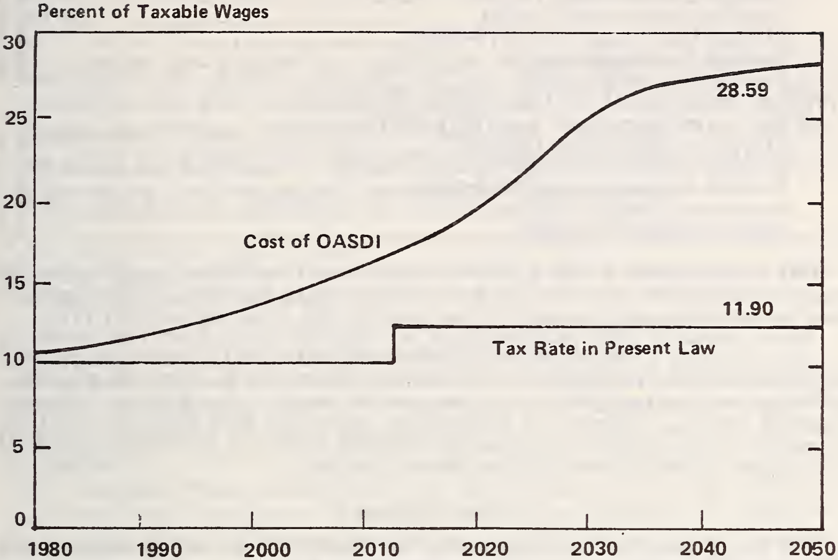
Advocates of general revenue financing cite the rapid growth in payroll taxes and the negative influence that this has on employment. But, checking the growth of payroll taxes via general revenue financing of Social Security is the least desirable and most controversial means of doing so. A more desirable method of increasing revenues without undermining the system would be to include member of Congress and federal employees in Social Security. The addition of 2½ million employees to the OASDI tax rolls would add about $2.5 billion annually in revenues. Mandatory coverage of all state and local employees would also add to OASDI revenues.

DECOUPLING

Increasing Social Security revenues via a tax rate increase as we suggest will solve the short-term financing problems and help toward meeting the long-range deficit as well. But solving the long-range deficit will require something more than moderate increases in Social Security taxes. Unless something is done to correct the over-adjustment for inflation that is now occuring with respect to initial benefit computations, future workers and their employers will face the prospect of a 30 percent OASDI payroll tax or about three times the combined tax paid by current workers and employers. (See exhibit 8.)

EXHIBIT 8

PROJECTED LONG-RUN COSTS AND EXISTING TAX RATES FOR OASDI, AS A PERCENTAGE OF TAXABLE WAGES



This is an unacceptable prospect which everyone wants to avoid. Fortunately, there is a near-unanimous agreement on how to avert this result. Because almost half of the long-range deficit is due to a faulty mechanism for adjusting benefits for inflation, there is an alternative to ever-increasing payroll taxes. This alternative is "decoupling."

Under the Social Security benefit formula written into law in 1972, an unintended escalation in benefit levels for future retirees is likely to occur under economic conditions. This is generally referred to as over-indexing for inflation, however, this does not apply to the present procedure for increasing benefits for persons already drawing Social Security.

Under the present system, future benefit amounts are affected by increases in the Consumer Price Index as well as by increases in the worker's earnings. This "coupled" approach to determining future benefits tends to over-adjust for inflation under the type of economic conditions that we are currently experiencing and are likely to have in the forseeable future. As a result, the initial benefit amounts for future retirees will rise faster than the wages on which they are based. Thus replacement rates—Social Security benefits as a percentage of final-year earnings—will rise in the future. If this situation is not corrected, many future retirees would get benefits that exceed their highest pre-retirement earnings. (Refer back to exhibit 4.)

We recommend that the present "coupled" benefit structure be "decoupled" in a way that would stabilize replacement rates at roughly 1970–71 levels. The computation of initial benefit amounts for workers retiring in the future would be separated from the automatic adjustment of benefit levels based on increases in the Consumer Price Index for people already on the rolls. In effect, future retirees' initial benefits would be tied to wage levels alone and not to both wages and the CPI as has been the case under the automatic adjustment provisions in current law.

Wage replacement rates in effect before 1972 should be reestablishd. By so doing, the cost of future benefits will be reduced but a reasonable level of benefits will be maintained. The decoupling proposal advanced by the American Council of Life Insurance (ACLI) would make this change and is preferable to the decoupling proposal suggested by the Administration which does not restore replacement rates to pre-1972 levels. (See exhibit 9.)

EXHIBIT 9.—Wage indexing at reduced replacement rate level compared to administration wage indexing

	Percent
ACLI proposal:	
Average medium-range cost (1977–2001)	11.0
Average medium-range revenue	9.9
Average medium-range deficit	—1.1
Average long-range cost (1977–2051)	13.7
Average long-range revenue	11.0
Average long-range deficit	—2.7
Proposal recommended by Carter administration:	
Average medium-range cost (1977–2001)	11.7
Average medium-range revenue	9.9
Average medium-range deficit	—1.8
Average long-range cost (1977–2051)	15.1
Average long-range revenue	11.0
Average long-range deficit	—4.1

Our organizations are in agreement that there is an urgent need to act this year on decoupling. Any further delay will result in additional double indexing and unwarranted and inequitable increases in the wage replacement ratio.

Social Security was established as a "floor of protection" for retirement income security. Each generation of retirees should have the same relative floor of protection, i.e., the same ratio of monthly benefits to pre-retirement monthly earnings as the last generation. Because we support the floor of protection concept and the constancy of replacement ratios, we have endorsed the ACLI formula for decoupling. Of all the decoupling formulas that we have examined, this comes closest to accomplishing these objectives.

CONCLUSION

We thank you for this opportunity to testify and we would welcome any questions you might have about our recommendations.

APPENDIX I

VALUES OF SELECTED ECONOMIC AND DEMOGRAPHIC FACTORS UNDER 3 ALTERNATIVE SETS OF ASSUMPTIONS, CALENDAR YEARS 1977–2051

Calendar year	Percentage increase in average annual: Wages	CPI	Real wages [1]	Average annual unemployment rate	Total fertility rate [2]
Alternative I:					
1977	8.4	6.0	2.4	7.1	1,709.9
1978	8.2	5.3	2.9	6.3	1,685.9
1979	7.9	4.6	3.3	5.6	1,662.0
1980	6.6	4.1	2.5	5.0	1,670.2
1981	5.8	3.4	2.4	4.5	1,710.5
1982	5.3	3.0	2.3	4.5	1,750.9
1983	5.25	3.0	2.25	4.5	1,791.2
1984 and later	5.25	3.0	2.25	4.5	[3] 2,300.0
Alternative II:					
1977	8.4	6.0	2.4	7.1	1,709.9
1978	8.1	5.4	2.7	6.3	1,685.9
1979	7.8	5.3	2.5	5.7	1,662.0
1980	7.1	4.7	2.4	5.2	1,662.9
1981	6.4	4.1	2.3	5.0	1,688.8
1982	6.0	4.0	2.0	5.0	1,714.7
1983	5.75	4.0	1.75	5.0	1,740.5
1984 and later	5.75	4.0	1.75	5.0	[3] 2,100.0
Alternative III:					
1977	8.4	6.0	2.4	7.1	1,709.9
1978	7.9	5.7	2.2	6.4	1,685.9
1979	8.1	7.6	.5	6.6	1,662.0
1980	8.2	5.9	2.3	6.6	1,648.4
1981	7.0	5.1	1.9	6.3	1,645.2
1982	6.5	5.0	1.5	6.0	1,642.1
1983	6.25	5.0	1.25	5.6	1,638.9
1984 and later	6.25	5.0	1.25	5.5	[3] 1,700.3

[1] Expressed as the difference between percentage increases in avarage annual wages and average annual CPI.
[2] Average number of children born per 1,000 women in their lifetime.
[3] This ultimate total fertility rate is not attained until after 1984. See app. A of the OASDI trustees report for more detailed informations.

Senator LONG. I will next call Mr. James M. Hacking, assistant legislative counsel of the American Association of Retired Persons—National Retired Teachers Association, accompanied by Thomas C. Borzilleri, senior staff economist, and Ralph Borsodi, economic consultant.

STATEMENT OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS—NATIONAL RETIRED TEACHERS ASSOCIATION, ACCOMPANIED BY THOMAS C. BORZILLERI, SENIOR STAFF ECONOMIST AND RALPH W. BORSODI, ECONOMIC CONSULTANT

Mr. HACKING. You already have our statement. Before I proceed with the summary, there is one housekeeping chore I would like, with your permission, to take care of.

On page 14 of my statement, halfway down the page, there is a figure ".1 percent." It should have read "6.1 percent."

While the immediate need of OASDI is additional financing, ultimately the programs need to be restructured if they are to serve the future generation of older persons as well as they are serving the current one.

We welcome the administrations' eight point financing package. The short- and long-term financial imbalance situation it addresses has continued to deteriorate and that, in turn, has spawned increasing anxiety among both beneficiaries and working contributors. We opposed last year's "do nothing" policy option and would object strongly to any further delay.

Moreover, we would oppose as any legislation that would merely allow the reallocation of assets between the OASI and DI trust funds such that they would be timed to topple over simultaneously but at a date somewhat later than the 1979 date on which the DI fund is now expected to run dry.

While our chief concern is assuring that benefits continue to be paid without interruption, we are also concerned over the equities and economic consequences of the financing package that is needed to assure that end.

We feel that there is an urgent need to circumscribe, to the extent possible, those areas of uncertainty which have become part of OASDI and have made sound financial planning virtually impossible. If replacement ratios and program costs are permitted to wander up and down the charts like stockmarket averages under the influence of the movements of wages, prices, and unemployment over time, neither the individual nor the Government can make proper financial plans. The present "coupled" system—a Rube Goldberg product—simply precludes sound financial planning.

Another area of uncertainty that must be narrowed is the unpredictable future costs of automatic benefit adjustments which are tied to annual inflation rates that have been historically high and erratic. For the last 2 years, our associations have proposed defraying the "net" benefit cost of automatic benefit increases, to the extent that they exceed 3 percent a year, out of general revenue.

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The point here is that the maximum 3 percent assumption creates a predictable basis for planning the payroll tax revenue needs of the system over time and planning for ultimate trust fund levels.

Another area of uncertainty arises as a result of the business cycle. Recessions happen. And when they do, they cut into the levels of tax revenues flowing into the system. The trust fund mechanism that has been used to compensate for this kind of uncertainty no longer seems adequate to deal with the simultaneous consequences of historically high, and continuing, rates of inflation and unemployment.

While we recognize that there are many other areas of uncertainty—such as mortality, migration, and fertility rates—these factors are much more predictable and much more readily accommodated in terms of financial planning. Our objective is to circumscribe those economic areas of uncertainty that are hard to predict, erratic in nature, and extraordinarily damaging to the financial viability of programs on which 33 million people depend. The system must be insulated, to the extent possible, from these.

With respect to the specific pieces of the administration's package, we endorse the proposed countercyclical use of general revenues on the grounds that, of the options available, it makes better economic sense and, by acting as an automatic stabilizer, it would assist financial planning for the system by curtailing an area of uncertainty. In the process, it would stabilize trust fund levels—an objective we deem essential to restoring and maintaining public confidence in the system.

We do not, however, support the administrations' proposal to allow a trust fund level to decline to one-third of a year's disbursements. We think a minimum equal to one-half of a year's disbursements is essential not only for public confidence, but also for the accommodation of future unforeseen financial problems on which Congress must have time to act.

Senator Long. Even though there was a general fund guarantee?

Mr. Hacking. Yes; even so. It has been some years since we have been confronted with a financing crisis in social security, and Congress still has not acted.

To offset the revenue consequences of this position with respect to trust fund levels, we would again urge the use of General Treasury funds tied to the cost of the above-3 percent portion of automatic benefit adjustments.

Senator Nelson. What is that again? Use the General Fund?

Mr. Hacking. To finance the above-3 percent portion of automatic benefit adjustments.

What we are calling for is two automatic stabilizers to narrow two areas of uncertainty, one with respect to the cost of the automatic benefit adjustment over 3 percent; the other with respect to payroll revenues that are lost when unemployment rates rise above the 6-percent level.

The former is a proposal that we advanced last year and the year before on the House side. Both are intended to facilitate present financial planning for the future needs of the programs.

With respect to the proposed changes in taxable wage base levels for employers and employees, our associations endorse them. Given the short-term OASDI revenue needs, these changes would help to

produce those revenues in a reasonably equitable manner that makes better economic sense at the present time than other alternative policy options.

Two other pieces of the financing package that we endorse are the increase in the payroll tax rate for the self-employed and the reallocation of a portion of the already scheduled HI rate increases. With respect to the latter proposal, we would point out that the enactment of the administration's Hospital Cost Containment Act makes the rate reallocation a "safe" thing to do.

Our associations are vigorously supporting the cost containment initiative, and we hope that this committee will be mindful that this piece of the social security financing package is intertwined with cost containment when that legislative measure comes before you.

Before turning to the longer range pieces of the package, we would like to state that legislation must be enacted soon to curtail those elements in the DI program that operate as strong incentives to come on the rolls and stay on. Incentives must be provided to move persons off the rolls and back into productive activity.

Moreover, DI administration must be made more uniform; the definition of disability—which is apparently applied in a highly subjective manner—must be made more objective in application; and far greater efforts must be made with respect to vocational rehabilitation. We urge close consideration of H.R. 8057.

Our associations believe that public policy in this country has fostered dependency, especially among the elderly, to the saturation point. A CBO study released last January and revised last month clearly demonstrates that, if it were not for the cash and in-kind benefit public transfer programs, 60 percent of the elderly family units would have been below the subsistence-based, official poverty level last fiscal year.

Senator Nelson. Sixty percent what?

Mr. Hacking. Of all family units headed by a person age 65 or older. That just shows you the lack of attachment the elderly now have to the labor market.

The point we want to make is that demographic trends demand that those public policies like mandatory retirement and the social security retirement test that discourage work effort and foster dependency among the elderly, must be phased out and be replaced with incentives to increase work effort and decrease dependency.

With respect to the administration's decoupling proposal, our associations support decoupling and the wage indexing approach because it would stabilize replacement ratios over time. That we deem essential to sound financial planning.

We oppose price indexing because replacement ratios would fall and that would likely increase the incidence of poverty among the future elderly.

Unfortunately, the administration's decoupling proposal underscores the major shortfall of the entire package. It is solely a financing package that assumes the perpetuation of the existing structure over time.

Our associations would have liked to use decoupling legislation as a vehicle for long-term reform. While we agree that the social secu-

rity system must be decoupled and support a wage-indexing approach, we do not agree that the benefit formula under such a decoupled system should produce replacement ratios roughly equivalent to those presently prevailing or that those ratios should vary inversely with average earnings/contributions.

We believe present replacement ratios are inadequate to assure a living standard during the later years of life that is at least comparable to that of the middle years.

Moreover, we believe the benefit formula should be much less heavily weighted—perhaps it should be proportional to contributions—to deemphasize the "floor-of-protection" function and emphasize instead the pension function by bringing about better correlation between contributions and benefits.

Senator NELSON. How would you raise the money to do that?

Mr. HACKING. There would be considerable savings by eliminating the weighted benefit formula and redistributing this so it is equal, across-the-board. Whatever you would derive in future benefits would be directly related to what you had contributed.

You can set your replacement ratio at some fixed figure, say 50 percent or 55 percent, then see what it would cost. Because there are trade-offs here, there could be established a future replacement ratio that assures the maintenance of living standards but, combined with other changes, would not result in program costs in excess of those presently projected for a decoupled OASDI program.

One of the problems of the system right now is that, for historical reasons, it has been used to try to reach conflicting goals. Since a new policy tool—the supplemental security income program—now exists, it should be used to perform the minimum income protection function.

Another advantage of an unweighted benefit formula is that it would deny the accruing of a windfall component in benefits awarded in the future to present employees who are able to split their employment histories between social security covered employment and employment covered by a nonsocial security-integrated retirement system.

As you recall, back in 1974 one of the major factors that almost destroyed the Railroad Retirement System was the effect of dual benefits and the windfall components of dual benefits on the financial interchange existing between Railroad Retirement and social security. We are recommeding something be done about this effect on the social security system as well.

Once an eligible individual comes onto the social security rolls, the benefit should of course be cost-indexed automatically in accordance with the movement of prices. However, we urge that a special elderly CPI be established that reflects the market basket of goods and services that the elderly—rather than urban, wageearners and clerical workers—consume and that this special index be used to adjust benefit levels. Also, we believe that something should be done to compensate for benefit level purchasing power losses due to time lags.

Finally, our associations do not support the administrations proposed acceleration of the 2 percent increase in payroll tax rates scheduled for the year 2011. We are calling for a restructuring of

the system and we believe that this proposal would be better viewed in that context.

In conclusion, Mr. Chairman, with the exceptions mentioned, our associations endorse the administration's financing package as a reasonable approach to the short- and mid-term financial imbalance problem of the system. However, it must be recognized as merely a package to finance the system as presently structured.

Our associations cannot support the perpetuation of the programs structured over the long term because we recognize that they would not meet, in an efficient, economically sound, equitable and cost-effective manner, the needs of the future elderly population.

We are disappointed that the administration did not—or was not able to—expand its package to include proposals with respect to the benefit structure, the coverage issues, the retirement test, the sorting out of the welfare, social adequacy, and pension aspects of the systems—and related and supportive systems—the problems of accruing windfalls to persons able to split their employment histories between different systems—except to correct the consequences of the recent Supreme Court decision in the *Goldfarb* case—and reform of DI.

While we recognize the urgent need to shore-up the programs financially, the Congress cannot begin too soon to recast the present system to accommodate labor force and demographic trends that are clearly visible. Long transitional periods are needed to bring about major changes in OASDI. We cannot wait until the consequences of present trends are near at hand. An atmosphere of impending crisis is not conducive to the making of informed policy decisions.

Senator NELSON. I agree with what you had to say about the disability insurance program. The DI program has expanded dramatically. It has disincentives to get off disability, to go to work. There are probably very few standards as to who is eligible for disability, but the fact remains that the DI fund will be depleted in a year. While I agree with your criticisms of the program, we must now concentrate on the immediate problem of financing.

I don't think we have time to do something about that now. I think we should have hearings this fall on the disability fund and try to redesign it at that time, but in terms of trying to do that now and passing such a reform measure before adjournment date, I don't think it's possible, do you?

Mr. HACKING. No, Senator. We think immediate action is needed to deal with the financing issues. We have been urging that for 2 years. But then this subcommittee should proceed to look at DI very closely and then at all the elements of OASDI. They are all tied together like scrambled eggs. Somebody is going to have to come along and sort these things out, sort out disability insurance from old age insurance, and maybe take old age insurance and make it into a pension system. Sort out some of those aspects that are in OASDI and put them other places, like in SSI where they can be performed efficiently and cost effectively.

These things cannot be done overnight. We understand that. But certainly, we have to begin looking at them right now. We cannot wait until 1985 or 1990 to be looking at the problem, because by then the demographic trends will be upon us and things will get out of control.

Senator NELSON. Plus, as you know, the decoupling has to occur this year.

Mr. HACKING. It gets worse every year. We know.

Senator NELSON. Senator Packwood?

Senator PACKWOOD. I have no questions, Mr. Chairman.

Senator NELSON. Thank you very much. We appreciate your taking the time to come.

[The prepared statement of Mr. Hacking follows. Oral testimony continues on p. 292.]

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. Chairman: I am James M. Hacking, Assistant Legislative Counsel for the 11 million member National Retired Teachers Association and the American Association of Retired Persons. With me are Thomas C. Borzilleri, our Senior Staff Economist and Ralph W. Borsodi, one of our economics consultants. As spokesmen for the large organizations of older people in the country, we are here to comment on the Administration's eight point social security financing package and offer a few thoughts for future action. While the immediate need of the cash benefit programs is for additional financing, ultimately we believe the programs need to be restructured if they are to serve the future generation of older persons as well as they are serving the current one.

I. THE SITUATION: FINANCIAL DETERIORATION/INCREASING ANXIETY

In 1975, OASDI outgo exceeded income by $1.5 billion. In 1976, the imbalance widened to $3.2 billion. For 1977, the OASDI Trustees' Report [1] projects a $5.6 billion excess of outgo over income (compared to last year's Trustees' projection of only $3.9 billion for 1977). In addition, the long-term imbalance, expressed as a percentage of taxable payroll has been widening from year-to-year. It now stands at 8.2 percent.[2] Last year it was projected at a level of 7.96 percent. The 1977 Trustees' Report concludes that in every year in the short (5 years), intermediate (25 years), and long term (75 years) projection periods, OASDI outgo will exceed income. If no additional revenue is supplied, the DI trust fund will be exhausted in 1979; the OASI trust fund will be exhausted at some point during the years 1982 to 1984.

Speaking on behalf of our members, we avoid expressing exaggerated concern over social security's financial integrity. The vast majority of our members hold the correct view that our country remains financially strong, that a solemn covenant exists between younger and older generations, and that the government, the guardian of that covenant, assures that commitments made under social security will be kept.

Nevertheless, persistent reports of crisis in social security financing and the repetition of distorted prophecies by assorted doomsayers who grab headlines at every opportunity cannot but create increasing anxiety on the part of both beneficiaries and working contributors. For two years, our Associations have urged that action be taken to bring system income and outgo into balance. We strongly objected to last year's "do nothing" policy option.

We welcome the Administration's financing proposals for a number of reasons. First, they would go far to restoring a shaken public's confidence in the system. Second, we find them reasonably equitable, economically preferred and legislatively viable. Third, they are much more in accord with the financing proposals that we have been advocating for the last two years. Finally, they are a welcome contrast to the preceding Administration's rather woodenheaded and legislatively unacceptable suggestions.

We flatly oppose any further temporizing with the system's financial problems. New approaches are needed which squarely meet the shortcomings of past financing procedures. We believe the Administration has supplied a package of thoughtful suggestions. They deserve careful consideration.

While our chief concern is assuring that benefits continue to be paid without interruption, we are also concerned over the equities and economic policy consequences of the financing package that is needed to assure that end.

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[1] 1977 OASDI Trustees Report.

[2] See table II in appendix, p. 27.

II. CIRCUMSCRIBING AREAS OF UNCERTAINTY

Our Associations endorse the Administration's financing package (with two exceptions). Not only does it assure benefit payments, but its proposed countercyclical use of general revenues and its mechanics for decoupling reduce (if not eliminate) a good deal of the uncertainty which has become part of the basic law and has made sound financial planning for the system virtually impossible.

a. Consequences of the present coupled system

The primary function of social security is replacement of income due to retirement—the quasi-pension aspect of the system. Since that is the case, contributors should know approximately what to expect from the system in the future by way of benefits (not only because they are entitled to know what their expected rate of return will be on their contributions, but also because they cannot adequately plan for retirement if they cannot estimate what portion of their retirement living expenses will be met by social security payments). If replacement ratios, and ultimate cost of the system) wander up and down the charts,[3] like stock market averages neither the individual nor the government can make proper financial plans. Reasonably stable replacement ratios are fundamental to sound pension planning.

b. Inflation: Its financial planning consequences

A second area of great uncertainty in planning for social security financing is the cost of adjusting the program for price changes created by the falling value of the dollar. Although the federal government has assumed (and rightly so) the responsibility for maintaining the purchasing power of benefits over time, the cost of automatic benefit adjustments to meet that responsibility is so completely unpredictable that private pension systems and most public employee systems at the state and local level ignore the issue or provide only limited protection.

Back in the 1960's, conventional economic wisdom tended to endorse increasing rates of inflation—at a range of 2 to 3 percent per-annum as normal conditions. That kind of creeping inflation could at least be accommodated. However, the public is now becoming slowly accustomed to accepting rates of 5 to 6 percent—the so called "hard core"—as normal. Neither we nor the system's trustees have any reason to believe that price inflation will be brought under control any time soon. Indeed, we expect inflation to continue to be eratic and expect it to be of the trotting variety—if not of the galloping variey.

Because inflation is certain, if unpredictable in amount, our Associations have, for the last two years, proposed that federal general revenues be used to "defray" the net benefit cost of automatic benefit increases to the extent that they exceed 3 percent a year, with the size of the annual general revenue contribution determined as follows: First, the aggregate cost for each fiscal year of the "above-three-percent-part" of automatic benefit increases effected in that and all prior fiscal years would be determined. Second, there would be set off against that amount, the yield for that year from all automatic wage base increases effected in that and prior fiscal years after deducting the cost (for that year) of the "three-percent-part" of all automatic benefit increases effected in that and all prior fiscal years.

We expected that as the rates of inflation and unemployment fell and the differential between the annual rate of increase in covered wages and inflation increased, the revenue generated through the automatic incrases in the taxable wage base would eventually balance out the aggregate cost of the automatic benefit increases in effect, thus phasing out the annual general revenue contribution automatically.

Although we are now much less sanguine about economic developments, we still advocate funding the above-three percent portion of automatic benefit increases out of general revenues—even if that requires a permanent infusion to the trust funds—because of the need to reduce an area of great cost uncertainty. The point here is that the three percent assumption creates a predictable basis for planning the needs of revenue to be derived from payroll taxes over time and planning for ultimate trust fund levels.

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[3] See tables III and IV in appendix, pp. 28, 29.

c. The business cycle: Its consequences for financial planning

A third area of uncertainty in planning social security revenues is the business cycle. Eliminating the cycle is apparently beyond the art of economists and government, although large numbers regularly try to exorcise the threats and consequences of recession and depression by repeating incantations from the works of John Maynard Keynes.

Recessions happen. And when they do, they cut into the levels of tax revenues needed to maintain social security payments. In the past, the OASI and DI trust funds, which are nothing more than contingency reserve funds, were meant to tide the system over periods of "hard times" when, temporarily, system outgo exceeds income. In effect, they act as an automatic stabilizing element in the economy. However, this trust fund, fail-safe approach to offset the negative impact on payroll tax revenues that recessions produce is no longer adequate. Inflation and unemployment contribute to each other with a result that it is likely to be many years before we manage to get both inflation and unemployment back down to manageable levels. Moreover, progress in that direction could be disrupted by any number of economic events such as world-wide commodity shortages, artificial increases in foreign and/or domestic energy prices or trade embargos. We cannot realistically anticipate that all the years ahead will be boom years for everyone, including the tax collector.

d. The non-pension aspects of the current system

Another area of uncertainty (there are others such as mortality, migration, fertility, labor force participation, etc.) is related to the cost of social welfare aspects of the social security programs as presently structured. If benefits were strictly related to total contributions, an addiional measures of uncertainty would have been removed from the financial planning needs of the system. We will address this area to a somewhat greater degree later in this statement.

e. The current situation: The product of too much uncertainty

The short and long-term financial imbalances in the social security system have become as serious as they have because of the enlargement of the areas of uncertainty in social security financial planning. The instability of benefit levels and their extraordinary sensitivity to the movements of wages and prices over time were unforeseen when the system was cost-indexed in 1972. The persistent and historically high rates of inflation over time and the impact of those CPI movements on benefit levels and costs were not predicted; nor was the severity of the recession that cut so deeply into payroll tax revenues; nor were the ultimated costs of the social welfare elements that were charged to the system.

III. THE ADMINISTRATION'S FINANCING PACKAGE

a. Contercyclical use of general revenues and trust fund Levels

The Administration has proposed a countercyclical use of federal general revenues to replace payroll taxes lost to the system as a result of unemployment rates in excess of 6 percent. Our Associations, having for the past two years recommended another type of countercyclical general revenue financing, strongly endorse this proposal. Of the policy options available, it makes the best economic sense and, by acting as an automatic stabilizer, it would assist financial planning for the system by curtailing uncertainty.

We feel the levels of the trust funds must be stabilized if the public is to have confidence in the system. We would urge that the levels of the funds be built up (over a reasonable period of time) until they are not less than the amount necessary to cover six months of disbursements. In this way, payments under the system would remain certain and would allow the Congress ample time to deal with totally unforeseen emergency financing problems in the future. We do not, therefore, support the Administration's proposal to allow trust fund levels to decline to one-third of a year's disbursements but we would offset the effects of our position by adding our own countercyclical general revenue devise tied to the cost of automatic benefit adjustments.

b. Taxable wage base increases

The Administration has also proposed changes in the taxable wage base for employers and employees. The change in the employers' tax burden would result from a three-step phase-out of the existing limit on the employers' wage

base. Ultimately (by 1981) employers would pay the scheduled payroll tax rates on their entire payrolls. Beginning in 1979, and in each alternate year through 1985 the employees' taxable wage base would be increased in $600 increments above the level that would otherwise exist under the automatic provisions. This would bring the wage base to approximately $30,300 by that final year. Our Associations endorse both changes in taxable wage base levels as necessary to produce needed revenues in a reasonably equitable manner. We think this approach also makes better economic sense at the present time than an across-the-board rate increase.

c. Rate increase for the self-employed

The Administration also proposes to raise the tax rate on the self-employed from 7 to 7.5 percent in 1979 to restore the historical relationship of 1½ to 1 between the self-employed and other employees with respect to social security taxes. Our Associations endorse this proposal and have advocated it for some time.

d. Reallocating a portion of scheduled HI rate increases

A shift of a portion of scheduled rate increases in the HI portion of payroll tax rates to the cash benefit trust funds is also part of the Administration's package. While we recognize that the HI trustees have projected an intermediate term (25 years) actuarial imbalance in the HI trust fund of 1.16 percent of taxable payroll, the system is well funded for the next five years and would benefit in any event from both the Administration's proposed countercyclical use of general revenues and the wage base increases. In addition, the Administration has advanced the Hospital Cost Containment Act of 1977 (vigorously supported by our Associations) which, if enacted, should serve to restrain the rate of increase in hospital costs reimburseable under the program, thus holding down the trustees' anticipated rate of increase in program costs.

IV. DI: IMMEDIATE ACTION REQUIRED

Before turning to the longer range pieces of the Administration's financing package, the issue of decoupling and other problems, we wish to comment briefly on the Disability Insurance program. According to this year's Trustees Report, under all three sets of alternative economic assumptions, DI trust fund outgo will exceed income in each year and trust fund assets will be exhausted sometime in 1979 unless legislation is enacted to correct the situation.

Our Associations find it difficult to understand why we as a nation are devoting 8.6 percent of our gross national product to health care ($140 billion last fiscal year) and at the same time are witnessing a burgeoning of the disability rolls and an enormous 21 percent a year rate of increase in disability insurance benefit costs. In 1970, there were approximately 2.5 million persons on the DI rolls; as of last year, the number had increased to 4.5 million. By 2055, if present trends continue, the number would increase to a conservative estimate of 10 million. Moreover, while there has been an enormous annual increase in the numbers of persons coming on to the DI rolls, there has been a percentage decrease in the number of beneficiaries being terminated due to recovery from disability. During 1975, only 1 percent were terminated.

Our Associations would urge that: (1) Legislation be enacted that would cut back those elements in the DI program that operate as strong incentive to come on the rolls and disincentives to get off (instead incentives should be provided to get off); (2) the Administration of the system be made more uniform; (3) the definition of disability (which is highly subjective) be made more objective; and (4) greater efforts be made with respect to vocational rehabilitation.

We are of course aware that the enactment of the SSI program thrust a hugh disability claims processing burden on the Social Security Administration and the vocational rehabilitation agencies at the state level. We are also aware that the recent economic "hard times" have caused many persons to apply for DI benefits when they might not have otherwise. Nevertheless, we have had adverse experience in programs costs exceeding prior year projections almost from the time of inception. The reports of the GAO that were done last year on DI claims processing and the BRP are devastating indictments of many of the legislated elements of the program as well as its administration at both the federal and state levels. We urge this committee to give close attention to the

provisions of H.R. 8057 which was introduced last month by House Social Security Subcommittee Chairman James Burke. Our only comment on that legislation at this time is that it may not go far enough.

V. LONG-RANGE FINANCING: DECOUPLING AND THOUGHTS FOR THE FUTURE

According to a CBO study released in January of this year ("Poverty Status of Families Under Alternative Definitions of Income") more than half of all elderly family units in this country would have fallen below the subsistence-based, official poverty level in fiscal 1976 had they not received assistance from cash and in-kind benefit public transfer systems such as Social Security, Medicare, SSI, Food Stamps, Veterans Pensions and Medicaid.[4] However, after counting all cash and in-kind benefits and allowing for taxes, only 0.1 percent of all elderly family units remained in the "poor" category. Of significance is the finding that social insurance programs, such as social security, were responsible for lifting an overwhelming 70 percent of the aged out of poverty.

These statistics have important implications for public policy. They indicate that our complex structure of income maintenance systems is bringing us closer to the goal of eliminating poverty in this country, especially with respect to the elderly. More importantly, however, these statistics illustrate that the elderly are extremely dependent (perhaps too dependent) on public transfer payments.

We cannot afford to feel secure, or complaisant with the results such as these. Our Associations are committed to developing and perfecting transfer programs so that they will better accommodate the changing needs of the people they serve now and will serve in the future. If improvements are not made, a combination of factors, one of the most important of which is inflation, could prompt a resurgence of poverty among our older population.

The present structure of programs benefitting the elderly is far from ideal. While it guarantees that most older persons will not be poor, it does not guarantee that during the later years of life they will be able to maintain a living standard at least equivalent to that attained in their earlier years. The present structure also fosters a high degree of dependency on public programs. This degree of dependency cannot be perpetuated since, in the future, the numbers of older people will increase dramatically relative to the workers on whom they will be dependent. Some have argued that this increase in the number of future older persons will be offset by the projected decrease in the number of young dependent children (because of fertility trends) and that dependency ratios will remain relatively constant over time. We would point out, however, that this does not mean younger family units will agree to pay substantially increased tax contributions to supporta future elderly dependent population which, to a large extent, will have the capacity (and desire) to remain economically productive and tax-paying. Finally, the present transfer structure can be legitimately criticized as being unnecessarily wasteful, inefficient, complicated and inequitable.

We offer some general goals for public policy in the process of reshaping the present income support structure to accommodate the changing needs of the population. First, the broad range of public transfer programs (both "means tested" and "non-means tested") should be structured and related so as to provide reasonable assurance that the living standard achieved in the middle years of life will not diminish in the later years. Second, the system should be structured to encourage revenue generating employment rather than dependency. Third, inequities should be reduced and changing needs accommodated. Finally, inefficiency and waste should be curtailed and fraud and abuse prevented.

The most serious limitation on our ability to achieve these goals of responsiveness, restructure, and equity even in the long run is the lack of additional available resources. Public transfer programs account for over one third of the federal budget pie. Additional resources can only come from: (1) the fiscal dividend that an expanding economy yields; (2) the savings that accrue through the more efficient, less wasteful and less duplicative operation of existing programs; (3) the savings that might accrue from reductions in existing benefits and (4) increased taxes.

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[4] See table V in appendix, p.30.

With respect to this later point, we would suggest that significantly increased tax burdens are certain to be resisted. Moreover, the prospect of a fiscal dividend is speculative since it depends on our achieving a optimum and steady rate of economic growth. Even if such dividend accrues, large portions of it are likely to be allocated among a number of priorities such as the beginnings of an NHI program and tax cuts. Additional resources to finance substantial benefit improvements and remedy inequities are thus extremely limited.

In terms of the social security system, our Associations are advocating a major restructuring in order to change the system gradually over time such that it will be able to accommodate the needs of the future elderly population. The present system provides an adequate earnings replacement base (a minimum of 55 percent) only for some. It is confronted with serious financial problems—problems that result from a combination of economic, demographic, and structural factors. Some of the fundamental assumptions that are reflected in the system's benefit and tax structures are either invalid or substantially less valid than they were in the past. As a result, social security is increasingly perceived as inequitable and is often the object of criticism. Disincentives to gainful employment like the retirement test (that are reinforced by other disincentives and arbitrary factors like mandatory retirement policies outside the system) must be replaced by incentives to remain in the labor force. Demographic trends and the general desire for an adequate income in later life require it. Reasons that led to the use of a single policy instrument—in this case, social security—to accomplish the conflicting objectives of earnings replacement and minimum floor of income protection are no longer operative since a new policy instrument—the Supplemental Security Income program—now exists. SSI rather than social security, can and should be used to achieve the floor of protection goal. Finally, there is an increasing need to coordinate social security with the underlying welfare programs and with other primary retirement systems for the purpose of distributing resources more equitably in the future and to avoid inordinately benefitting a few at the expense of many.

While our Associations are advocating a restructuring of the cash programs of social security, we have kept in mind important limitations. First, the reality of the present system imposes substantial constraints on the scope of reform and the rapidity with which it can be achieved. For example, a shift in emphasis away from social adequacy and toward individual equity within the system requires that changes be made among the mix and magnitudes of benefits awarded in the future. However, in making such changes, no one in current benefit status nor those approaching benefit status should be disadvantaged. Second, additional resources to facilitate such a substantial reform are extremely limited. Finally, because the system is so large, proposed changes must be analyzed in terms of their potential impact upon the domestic economy and in the light of the domestic economy's impact upon the system.

As part of its financing package, the Administration is advancing a decoupling proposal that would index the earnings/contributions record of present workers in the computation in their future benefit awards in accordance with the movement of wages over time. We support "decoupling" and the wage indexing approach. We oppose price indexing because replacement ratios would fall (likely increasing the incidence of poverty among the future elderly).

We recognize that the Administration's decoupling proposal, if enacted, would cut the currently projected 8.2 percent actuarial imbalance to 4.46 percent (assuming that the economic assumptions with respect to the movement of wages, prices, unemployment and fertility hold true over the 75-year period).[5] However, the Administration's decoupling proposal underscores the major shortfall of the entire package—it is solely a financing package that assumes the perpetuation of the existing structure over time. Our Associations would have liked to use decoupling legislation as a vehicle for long-term reforms. While we agree that the social security system must be decoupled and support a wage indexing approach, we do not agree that the benefit formula under such a decoupled system should produce replacement ratios roughly equivalent to those presently prevailing. We believe present replacement ratios are inadequate to assure a living standard during the later years of life that is at least comparable to that of the middle years. Moreover, we believe that the benefit

[5] See tables VI and VII in appendix, pp. 31, 32. For effect of total Administration financing package on the long-term financial imbalance see Table VIII in appendix, p. 33.

formula should be much less heavily weighted (perhaps even proportional to contributions) than either the present one or the one which the Administration's proposal contemplates. Such a benefit formula would deemphasize the "floor protection function" and emphasize instead the pension function to bring about better correlation between contributions and benefits.

One of the problems of social security is that historically it has, albeit for good reasons, been used to achieve conflicting goals. As we stated above, the SSI program has now been created and we hope that some of that conflict can be eliminated by weighing the social security formula much less heavily and by augmenting SSI to assume more fully the floor of protection function with respect to those who work at low wages and/or have sporatic attachment to the labor force. Future combined social security and SSI benefits should be such that beneficiaries would suffer no net benefit loss as a result of a swing away from a heavily weighted formula. These changes we believe would make for a more efficient use of resources and would have other advantages. First, since higher average replacement ratios would mean higher PIA's, greater benefit recognition would be accorded to the contributions of women who work (provided some kind of a freeze similar to the disability freeze, is applied to those non-labor force participation years that are devoted to raising children). Second, survivors would be helped. Finally, future retirees with split employment histories (employees covered under public retirement systems not integrated with social security) would receive little or no windfall component in any social security benefit to which they may become entitled.

Of course once an eligible individual comes onto the social security rolls, his benefits should be indexed automatically in accordance with the movement of prices. For adjusting benefits, we have proposed a special elderly CPI that reflects the market basket of goods and services that the elderly (rather than urban wage earners and clerical workers) consume. We have also recommended that adjustments be made bi-annually rather than annually or, if bi-annual adjustments are not administratively possible, that the first payment received after an annual adjustment include what we call a one-time "catch-up" payment that would compensate for the accumulated purchasing power lost from the time of the last adjustment. Finally, we strongly support the use of a transitional period to phase in the decoupled system in order to avoid sharp reductions in benefit amounts from one year to another and the inequities that that would produce—even though we recognize that, in the short term, the use of a transitional provision will increase program costs over what they would otherwise be under the current system.

The Administration's proposed acceleration of the 2 percent increase in payroll tax rates scheduled for the year 2011 (with one quarter becoming effective in 1985 and the other three quarters effective in 1990) does not have our Associations' support at this time. We are calling for a restructuring of the system and we believe that this proposal would be better viewed in the context of such a major restructuring.

VI. CONCLUSION

In conclusion, Mr. Chairman, we endorse the Administration's financing package (except for the decrease in trust fund revenue levels and the acceleration of the payroll tax rate increase now scheduled for the year 2011) to meet the near and mid term financial imbalance of the system. However, we recognize that the financing package assumes the perpetuation of the system as it is presently structured. We cannot support the perpetuation of the programs as presently structured over the long term because we recognize that it would not meet, in an efficient, economically sound, equitable and cost effective manner, the needs of the future elderly population. We are disappointed that the Administration was not able to expand its package to include proposals with respect to the benefit structure, the coverage issues, the retirement test, the sorting out of the welfare, social adequacy and pension aspects of the system (and related supportive systems), the problem of accruing windfalls to persons able to split their employment histories between different systems (except to correct the consequences of the recent Supreme Court decision in the *Goldfarb* case) and the legislative reform of the DI program (the costs of which have so significantly aggravated the short and long term financial imbalances of the combined cash benefit programs). While Congressional attention must be directed immediately at the financing issues, these other important issues continue to fester and will require resolution soon.

TABLE I.—VALUES OF SELECTED ECONOMIC AND DEMOGRAPHIC FACTORS UNDER 3 ALTERNATIVE SETS OF ASSUMPTIONS, CALENDAR YEARS 1977–2051

Calendar year	Percentage increase in average annual— Wages in covered employment	CPI	Real wages [1]	Average annual unemployment rate	Total fertility rate [2]
Alternative I:					
1977	8.4	6.0	2.4	7.1	1,709.9
1978	8.2	5.3	2.9	6.3	1,685.9
1979	7.9	4.6	3.3	5.6	1,662.0
1980	6.6	4.1	2.5	5.0	1,670.2
1981	5.8	3.4	2.4	4.5	1,710.5
1982	5.3	3.0	2.3	4.5	1,750.9
1983	5.25	3.0	2.25	4.5	1,791.2
1984 and later	5.25	3.0	2.25	4.5	[3] 2,300.0
Alternative II:					
1977	8.4	6.0	2.4	7.1	1,709.9
1978	8.1	5.4	2.7	6.3	1,685.9
1979	7.8	5.3	2.5	5.7	1,662.0
1980	7.1	4.7	2.4	5.2	1,662.9
1981	6.4	4.1	2.3	5.0	1,688.8
1982	6.0	4.0	2.0	5.0	1,714.7
1983	5.75	4.0	1.75	5.0	1,740.5
1984 and later	5.75	4.0	1.75	5.0	[3] 2,100.0
Alternative III:					
1977	8.4	6.0	2.4	7.1	1,709.9
1978	7.9	5.7	2.2	6.4	1,685.9
1979	8.1	7.6	.5	6.6	1,662.0
1980	8.2	5.9	2.3	6.6	1,648.4
1981	7.0	5.1	1.9	6.3	1,645.2
1982	6.5	5.0	1.5	6.0	1,642.1
1983	6.25	5.0	1.25	5.6	1,638.9
1984 and later	6.25	5.0	1.25	5.5	[3] 1,700.0

[1] Expressed as the difference between percentage increases in average annual wages and average annual CPI.
[2] Average number of children born per 1,000 women in their lifetime.
[3] This ultimate total fertility rate is not attained until after 1984.

TABLE II.—ESTIMATED EXPENDITURES OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL FOR SELECTED YEARS, 1977–2055 UNDER ALTERNATIVE II

[In percent]

Calendar year	Expenditures as percent of taxable payroll [1] — Old-age and survivors insurance	Disability insurance	Total	Tax rate in law	Difference
1977	9.40	1.50	10.91	9.90	−1.01
1980	9.21	1.59	10.80	9.90	−.90
1985	9.64	1.92	11.56	9.90	−1.66
1990	10.12	2.27	12.39	9.90	−2.49
1995	10.50	2.64	13.14	9.90	−3.24
2000	10.79	3.12	13.91	9.90	−4.01
2005	11.30	3.66	14.96	9.90	−5.06
2010	12.46	4.11	16.57	9.90	−6.67
2015	14.47	4.42	18.89	11.90	−6.99
2020	17.05	4.59	21.64	11.90	−9.74
2025	19.75	4.55	24.30	11.90	−12.40
2030	21.57	4.45	26.02	11.90	−14.12
2035	22.26	4.43	26.69	11.90	−14.79
2040	22.12	4.55	26.67	11.90	−14.77
2045	21.83	4.76	26.59	11.90	−14.69
2050	22.02	7.91	26.93	11.90	−15.03
2055	22.53	4.98	27.51	11.90	−15.61
25-yr averages:					
1977–2001	10.00	2.24	12.24	9.90	−2.34
2002–26	14.65	4.20	18.85	11.19	−7.67
2027–51	21.86	4.61	26.47	11.90	−14.57
75-yr average: 1977–2051	15.51	3.68	19.19	10.99	−8.20

[1] Expenditures and taxable payroll are calculated under the intermediate set of assumptions (alternative II) which incorporates ultimate annual increases of 5¾ percent in average wages in covered employment and 4 percent in CPI, an ultimate unemployment rate of 5 percent, and an ultimate total fertility rate of 2.1 children per woman. Taxable payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "express wages" as compared with the combined employer-employee rate.

TABLE III.—ILLUSTRATIVE REPLACEMENT RATIOS FOR RETIRED MALE WORKERS AT SELECTED EARNINGS LEVELS UNDER VARIOUS ECONOMIC ASSUMPTIONS

Earnings level (1)	Replacement ratio [1] based on retirement at age 65 in January of 2050, under assumptions of [2]— 1977 (2)	5–2¾ (3)	5–3 (4)	6–4 (5)	5¾–4 (6)
Workers without spouse:					
Maximum	0.33	0.34	0.38	0.44	0.48
Median	.46	.47	.54	.64	.70
Low	.58	.68	.79	.96	1.06
Worker with spouse aged 65:					
Maximum	.50	.51	.57	.67	.72
Median	.69	.71	.81	.95	1.04
Low	.88	1.02	1.19	1.44	1.59

[1] The replacement ratios are defined in the text.
[2] The 2 figures shown in each co umn heading represent assumed annual percentage increases in average wages in covered employment and in average CPI, respectively, during the period 1983–2050. During 1977–82, the assumed rates of increase in wages and in CPI are based on the pattern of those included in the intermediate set of assumptions (alternative II).

TABLE IV.—ESTIMATED LONG-RANGE EXPENDITURES OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM AS PERCENT OF TAXABLE PAYROLL, UNDER ALTERNATIVE II AND UNDER VARIOUS CONSUMER PRICE INDEX ASSUMPTIONS

[In percent]

System	Average expenditures as percent of taxable payroll [1] assuming ultimate wage-CPI increases of [2] 3¾–2	5¾–4	7¾–6
25-yr period:			
Present law	12.16	12.24	12.34
Modified theoretical	12.06	11.96	11.86
50-yr period:			
Present law	14.48	15.54	16.72
Modified theoretical	13.84	13.72	13.62
75-yr period:			
Present law	16.58	19.19	21.96
Modified theoretical	15.58	15.45	15.33

[1] Taxable payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as combined with the employer-employee rate.
[2] The initial value in each pair refers to the assumed annual percentage increases in average wages after 1982. The 2d value refers to the assumed annual percentage increases in CPI after 1982. The assumptions used in the 1977–81 period were adjusted so as to gradually reflect the ultimate change. All other assumptions are given by alternative II.

TABLE V.—FAMILIES BY AGE BELOW THE POVERTY LEVEL UNDER ALTERNATIVE INCOME DEFINITIONS: FISCAL YEAR 1976

Families in poverty	Pretax/ pretransfer income	Pretax/ postsocial insurance income	Pretax/ postmoney transfer income	Pretax/post-in-kind transfer income [1]		Posttax/posttotal transfer income [1]	
				I	II	I	II
A. Under 65:							
Number in thousands	11,789	8,994	8,029	6,710	5,463	6,886	5,615
Percent of under 65	18.6	14.2	12.7	10.6	8.6	10.9	8.9
B. 65 and over:							
Number in thousands	9,647	3,459	2,686	2,268	977	2,279	982
Percent of 65 and over	59.9	21.5	16.7	14.1	6.1	14.1	6.1

[1] Col. I excludes medicare and medicaid benefits received by families participating in those programs; col. II includes medicare and medicaid benefits.

TABLE VI.—COMPARISON OF AVERAGE EXPENDITURES AND TAXES FOR MODIFIED THEORETICAL OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL UNDER ALTERNATIVES I, II, AND III

[In percent]

Item	Alternative I	Alternative II	Alternative III
1st 25-yr period (1977–2001):			
Expenditures as percent of taxable payroll	11.56	11.96	12.36
Tax rate in law	9.90	9.90	9.90
Difference	−1.66	−2.06	−2.46
Total 75-yr period (1977–2051):			
Expenditures as percent of taxable payroll	14.25	15.45	17.51
Tax rate in law	10.99	10.99	10.99
Difference	−3.26	−4.46	−6.52

Notes: See text for description of modified theoretical system. Taxable payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages as compared with the combined employer-employee rate. Alternatives I, II, and III are described in table.

TABLE VII.—COMPARISON OF AVERAGE EXPENDITURES AND TAXES FOR OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM UNDER PRESENT LAW AS PERCENT OF TAXABLE PAYROLL UNDER ALTERNATIVES I, II, AND III

[In percent]

Item	Alternative I	Alternative II	Alternative III
1st 25-yr period (1977–2001):			
Expenditures as percent of taxable payroll	11.57	12.24	13.14
Tax rate in law	9.90	9.90	9.90
Difference	−1.67	−2.34	−3.24
Total 75-yr period (1977–2051):			
Expenditures as percent of taxable payroll	14.87	19.19	27.08
Tax rate in law	10.99	10.99	10.99
Difference	−3.88	−8.20	−16.09

Notes: Taxable payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate. The assumptons specified in alternatives I, II, and III are described in table.

TABLE VIII.—*Effect of proposals on longer run deficits*

	Percent
Effect on average 25-year deficit (1977–2002):	
Deficit under present law	−2.3
Effect of short-run financing plan	+1.3
Effect of decoupling plan	+.4
Effect of tax rate shift	+1.1
Resulting 25 year surplus	+.5
Effect on average 75-year deficit (1977–2051):	
Deficit undei present law	−8.2
Effect of short-run financing plan	+1.7
Effect of decoupling plan	+4.0
Effect of tax rate shift	+0.6
Remaining 75-year deficit	−1.9

TABLE IX.—*Administration shortrun financing plan for social security cash benefit programs*

[1978–82 aggregates excluding interest earnings]

	Billions
Additional financing needed under conventional payroll tax approach	$83
Administration plan to meet the needs:	
Countercyclical general revenues:	
Additional revenues produced [1]	14. 1
Savings from lower reserve ratio	24. 1
Tax employer on full earnings of employee [1] (phased in over 3 years)	30. 4
$1,200 increase in employee earnings base ($600 in 1979 and $600 in 1981)	3. 5
Shift of medicare tax rate	7. 2
Increase in self-employment tax rate	1. 2
New eligibility test for dependents' benefits	2. 6
Total new financing provided	83

[1] Includes new revenues initially going to hospital insurance (HI) fund but reallocated to cash benefit funds through transfers of the HI tax rate.

TABLE X.—STATUS OF THE SOCIAL SECURITY TRUST FUNDS: RECENT HISTORY AND PROJECTIONS OF CURRENT LAW USING 1977 TRUSTEES REPORT ASSUMPTIONS

	Old-age, survivors, and disability insurance, combined					Hospital insurance		
Year	Combined tax rate, percent	Earnings base	Change in trust funds (billions)	Ending trust fund balance (billions)	Beginning reserve ratio [1]	Combined tax rate, percent	Beginning reserve ratio [1]	OASDHI combined tax rate, percent
Historical:								
1974	9.9	$13,200	+$1.5	$45.9	73	1.8	69	11.7
1975	9.9	14,100	−1.5	44.3	66	1.8	79	11.7
1976	9.9	15,300	−3.2	41.1	57	1.8	77	11.7
Projected:								
1977	9.9	16,500	−5.6	35.5	47	1.8	66	11.7
1978	9.9	17,700	−6.9	28.6	36	2.2	55	12.1
1979	9.9	18,900	−7.9	20.7	27	2.2	56	12.1
1980	9.9	20,400	−9.1	11.6	18	2.2	53	12.1
1981	9.9	21,900	−11.5	.1	9	2.7	45	12.6
1982	9.9	23,400	−14.9	−14.8	0	2.7	50	12.6

[1] Ratio of trust fund at beginning of year to expenditures during year.

TABLE XI.—SOURCE OF ADDITIONAL REVENUES PRODUCED BY ADMINISTRATION PLAN

[In billions of dollars]

Year	Change in trust funds current law	Removing base for employers	Counter-cyclical general revenues	Increasing base for employees	Increasing self-employment tax rate	Reduced outgo[1]	Reallocation of part of HI rate	Added interest income	Total effect	Change in trust funds under plan
Old-age, survivors, and disability insurance:										
1978	−6.9		+5.5			+0.1	+1.6	+0.3	+7.5	+0.6
1979	−7.9	+2.1	+3.6	+0.4	+0.1	+.3	+2.0	+.8	+9.4	+1.4
1980	−9.1	+5.0	+2.8	+.5	+.3	+.6	+2.3	+1.5	+13.0	+3.9
1981	−11.5	+8.1		+.9	+.4	+.9	+4.8	+2.5	+17.6	+6.1
1982	−14.9	+9.0		+1.0	+.4	+1.5	+5.4	+3.7	+20.9	+6.0
Hospital insurance:										
1978	+1.9		+1.0			+.8	−1.6		+.1	+2.0
1979	+1.2	+.5	+.7	+.1		+1.3	−2.0	+.1	+.7	+1.9
1980	−.1	+1.1	+.5	+.1		+2.0	−2.3	+.1	+1.5	+1.4
1981	+3.6	+2.2		+.2		+2.7	−4.8	+.2	+.4	+4.0
1982	+2.3	+2.4		+.3		+3.4	−5.4	+.2	+.9	+3.2
Cumulative total, 1977–82:										
OASDI	−50.3	+24.2	+11.9	+2.8	+1.2	+3.5	+16.1	+8.8	+68.4	+18.1
HI	+8.8	+6.2	+2.2	+.7		+10.2	−16.1	+.6	+3.7	+12.5
Total	−41.5	+30.4	+14.1	+3.5	+1.2	+13.6		+9.4	+72.1	+30.6

[1] Includes effect of institution of new dependency test, decoupling, and hospital cost containment.

Note: Individual items may not add to total due to rounding.

Senator NELSON. Our next witness is Mr. Michael Mett, supervisor, Milwaukee County, Wis., and chairperson of the NACO Interim Pension Task Force, speaking on behalf of the National Association of Counties.

Would you please identify your associate so that the record will be accurate?

STATEMENT OF R. MICHAEL METT, SUPERVISOR, MILWAUKEE COUNTY, WIS., AND CHAIRPERSON, NACO INTERIM PENSION TASK FORCE, ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES, ACCOMPANIED BY ANN SIMPSON, NACO LEGISLATIVE REPRESENTATIVE

Mr. METT. Good morning, Mr. Chairman. I have here with me Ann Simpson, legislative representative from the National Association of Counties.

My name is Michael Mett. I am county supervisor, Milwaukee County. I am also chairman of the interim pension task force authorized by the Board of Directors of the National Association of Counties last year to study the status of county pension plans and the impact of proposed Federal regulation.

The interim pension task force was also charged with examining the impact of Federal pension regulation and proposed social security changes upon the frequency of public employers and public employees to withdraw from participation in the Federal social security system.

My background in public finance and pension matters stems in part from my experience as counsel and acting commissioner for the Wisconsin Securities Commission between 1968 and 1971 and my service as an elected local official since 1973. I have also served on the staffs of several State and Federal agencies in my 16 years of public life. I am a member of the State Bar of Wisconsin and the American Bar Association, and have taught securities analysis and portfolio management in the University of Wisconsin system.

On behalf of NACO and Milwaukee County, I am pleased to have the opportunity to appear before you as you consider the best way to restore the financial soundness of the social security program. Our major concern is that in your deliberations you give careful consideration to the impact on local governments and their participation in the social security program.

The Social Security Act as amended does not mandatorily cover public employers and employees because of a constitutional limitation on the ability of the Federal Government to levy any general levy of an employer's tax on State or local governments. NACO supports the optional inclusion of the public sector work force in the social security system and opposes any legislative efforts to extend coverage mandatorily to the pubic sector.

Senator NELSON. Are you saying that a provision of the Constitution would prohibit the mandatory requirement that State or local employees be covered?

Mr. METT. At the time that these issues were deliberated upon, it was apparently the impression of Congress that there was such a

constitutional prohibition. I do not know if it has been tested recently. I am not sure whether the National League of Cities' case would shed any light on that.

But the participation on behalf of public employees in State and local governments was left voluntary under the Social Security Act as originally drafted and amended.

Senator NELSON. A number of witnesses have testified that we should amend the law to make it mandatory, but nobody raised a constitutional question about it. You are the first one to do so.

Mr. METT. I am advised that it is an issue. I do not appear here to elaborate at any length on that.

Senator NELSON. I am glad you raised the question. I want that point checked. I had not thought about a possible constitutional prohibition.

For my own information, does the Wisconsin retirement law make it mandatory that local governments, as well as States, participate in social security?

Mr. METT. In 1973, the Wisconsin Legislature passed a law taking away the right of its local units of government under home rule to withdraw, filing their own notices of withdrawal. So in order for Milwaukee County to withdraw, we would not only file a notice, we would have to get the State legislature to change that law allowing our withdrawal.

However, many States do not have a State prohibition and many districts in California have taken the election to withdraw.

In any event, Mr. Chairman, NACO opposes efforts to bar, limit or inhibit the voluntary withdrawal of local and State governments from the social security system when withdrawal is deemed by local elected officials to be in the best interests of their respective county, municipal or State governments. NACO strongly supports efforts by the Congress to improve the social security system so that withdrawal will be less necessary or attractive, but the option for withdrawal should remain as is under current law.

Current government statistics show a creeping trend toward withdrawal from the system. For the 18-year period 1959 through 1977, 401 State and local units of government, representing 54,000 employees, have withdrawn from Social Security. Pending termination requests through December 1978, cover 325 additional State and local governments, representing 505,726 employees including the city of New York and the State of Alaska. New York and Alaska, however, are reportedly expected to withdraw their termination request—a notice to withdraw can be terminated any time during the 2-year period before withdrawal actually occurs.

A number of units withdrawing from the system have cited the financial burden of participation as the principal reason for their action. The recession and the terrible impact of inflation upon State and local budgets has been, and will continue to be, the basis for these fiancial problems.

The 1976 annual report of the Board of Trustees of the Federal Old Age and Survivors' Insurance and Disability Insurance Trust Funds indicated on page 65 that the termination of coverage of any

large number of State and local government employees would have an adverse effect on the trust funds, especialy in the short range.

I might point out here that the figures do not show any pro forma impact of potential withdrawals, or those with withdrawals pending.

NACO believes that greater withdrawals from the social security system which might result from changes in funding of that system should receive close study, particularly insofar as perceptions about the integrity and character of social security as substantially an insurance system are concerned. NACO also expresses concern that any social security funding changes include language and policy which would discourage withdrawals from the system by local units of government.

For example, the impact on both Milwaukee County and the social security system resulting from withdrawals by Milwaukee County's 10,000 employees would be: (*A*) "Savings" to Milwaukee County of $6.8 million in social security employer's payroll taxes.

Senator NELSON. The Milwaukee County retirement system, the State system, is integrated with social security. There is a double contribution. Part of it goes to the Milwaukee pension system and the social security part goes to social security. Is it not historically correct that as social security went up, contributions to the pension went up?

Mr. METT. Not necessarily.

Senator NELSON. The State?

Mr. METT. The State may, but in Milwaukee, the city and county have home rule pension plans. We have an offset as regards both contributions and benefits, so that we have a possibility for windfall benefits because we took off the offset feature in our county pension plans in 1964. So that the replacement ratio. when you add both the county benefits and the social security benefits, can be very high.

Senator NELSON. So you are saying, if Milwaukee county withdrew without another program, you would have $6.8 million?

Mr. METT. For starters. I go on to observe for NACO another impact would be the need by the county to purchase or to provide similar coverage from replacement benefit plans, of course, to take care of the new employees who obviously would bargain under our public bargaining laws for similar benefits once the withdrawal had taken place.

This would result in the expenditure of much of the $6.8 million "saved" by withdrawal. A recent study by the Special Committee on Aging indicated that such replacement plans usually cannot match the breadth of the social security coverage, especially in the areas of survivors' coverage, disability coverage, and prepaid health insurance such as provided by medicare.

NACO also expresses concern that the impact of any changes in financing for social security will weaken the insurance principle and earnings-related nature of the system and will, in doing so, actually operate to stimulate withdrawal.

Senator NELSON. What kind of changes are you talking about?

Mr. METT. Mr. Chairman, this would be what would remain after a significant change in policy, to drop the use of general revenues

to supplant the need for any additional payroll taxes. We are talking about the substance and the perception of what the system is.

We go on to observe that the line of reasoning here is that once significant general revenue funding is approved to cure financing problems in the social security system, current public employees may well ask "why should we continue to finance a system from our payroll taxes and local taxpayer's pockets which will already provide us benefits without any further contributions?"

NACO is trying to determine from within its membership whether such general Federal revenue payments for social security would generate such a reaction. While some States, like Wisconsin, have laws preventing withdrawal from the social security system by their local units of government, many States do not have such statutes. It appears, therefore, that relevant State laws, the attitudes of county employees, the true cost of replacement plans, and how gaps in the replacement plans would be addressed, all of the above appear to be appropriate questions for Congress to ask in evaluating the prospects for increased withdrawals if funding of social security is changed.

Thus, while the prospect for withdrawal from the system by public employees is a constant possibility, any change in the funding for social security can be expected to have several impacts on local units of government. For example, the direct and indirect impact on Milwaukee County of adoption of the administration's social security proposals would be as follows:

One: County property taxes would have to be increased $2 million or 3 percent just to pay for the one-time increase of 15 percent in the county employer's share of payroll taxes.

This is based on the review of the salary composition of our 10,000 employees.

Senator NELSON. That provision which requires the employer to contribute on the total salary?

Mr. METT. That is correct. This is a pro forma increase, and we would indicate, by 1981, full salary on the employer.

Senator NELSON. You say that would be $2 million or a 3-percent increase?

Mr. METT. That is because our tax levy for general purposes in Milwaukee County is $86 million right now. If you pass that $2 million across that, you come up with 3 percent.

Because of the composition of our employees, the mix we have, it would actually be a net line item in the county's budget of 15 percent, a one-time increase. Of course, next year, with the changes already built in, we expect approximately an 8-percent increase in our employers' taxes. That is already written into law.

We think also another impact would be that county officials would become apprehensive that the new demands placed upon Federal revenues by the social security trust fund would decrease the amount of Federal aid available for other programs in the future.

Three: Large urban counties like Milwaukee, with stable if not shrinking tax bases, would have to lay off employees or reduce services to meet this new "mandated" Federal expense within their already limited resources.

Because the greatest growth in public employment is taking place at State and local levels, greater percentages of payroll tax funding for social security will come from contributions from State and local government employees. We must, therefore, take steps to "squelch" any stimulus to withdraw from the social security system, whether it results from changes in funding arrangements or from changes in benefit levels. The National Association of Counties taxation and finance, welfare and social services, and labor-management relations policy steering committees will be asked to form a task force and report by letter to your committee a more thorough response of impact on counties should the administration's funding proposals for social security be adopted.

Thank you, Mr. Chairman, and members, for the opportunity to appear before this subcommittee. I will be happy to answer any questions.

Senator NELSON. Assuming we will act on this proposal before the adjournment in October, when might this task force have a letter to us on the impact on the penalties of the funding proposals? Do you have any notion?

Mr. METT. The National Association of Counties has their annual meeting in Detroit later this month, so these issues are going to be discussed. The board of directors—and Miss Simpson can speak to this—will be asked to consider these items, should this subcommittee so desire, and report back in a timely fashion.

Ms. SIMPSON. I would think early August, immediately following our annual meeting.

Senator NELSON. I would hope that the task force would be able to have something for us by the 15th of August, if that will give you enough time.

If you could get that information to us, we would appreciate it. We may have, and I think we will have, further questions for the counties, States, and other groups. I am assuming that if we submit some questions by mail you can respond to us in writing.

Mr. METT. We would be happy to.

I might point out, Senator, I was listening to a discussion earlier on the DI trust fund. Some of my views have been shaped by an interesting article on some of these disability terminations in the Harvard Law Review, by Mr. Stuart, a former classmate of mine. It was in the Harvard Law Review 12, 16 months ago. If you like, I will send you a copy of that.

Senator NELSON. I would like to see a copy of it. Someone made reference to it in testimony at a previous time.

The question of earnings, $30,000 in 1 year—I heard some testimony on that point. If you would send me the article, I would appreciate it.

Mr. METT. We will be happy to. Thank you for your interest.

Senator NELSON. Thank you very much. I appreciate your taking the time to come.

[The prepared statement of Mr. Mett and the Harvard Law Review article follows. Oral testimony continues on p. 318.]

STATEMENT OF THE HONORABLE R. MICHAEL METT, SUPERVISOR, MILWAUKEE COUNTY, WISCONSIN, ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES (NACo)

Mr. Chairman and members of the subcommittee, I am Michael Mett, supervisor, Milwaukee County, Wis., and chairman of the interim pension task force authorized by the board of directors of the National Association of Counties (NACo)[1] last year to study the status of county pension plans and the impact of proposed Federal regulation. The interim pension task force was also charged with examining the impact of Federal pension regulation and proposed social security changes upon the frequency of public employers and public employees to withdraw from participation in the Federal Social Security System. I am accompanied by Ann Simpson, NACo legislative representative.

My background in public finance and pension matters stems in part from my experience as counsel and acting commissioner for the Wisconsin Securities Commission between 1968 and 1971 and my service as an elected official since 1973. I have also served on the staffs of several State and Federal agencies in my 16 years of public life. I am a member of the State Bar of Wisconsin and the American Bar Association and have taught securities analysis and portfolio management in the University of Wisconsni system.

On behalf of NACo and Milwaukee County, I am pleased to have the opportunity to appear before you as you consider the best way to restore the financial soundness of the social security program. Our major concern is that in your deliberations you give careful consideration to the impact on local governments and their participation in the social security program.

The Social Security Act as amended does not mandatorily cover public employers and employees because of a constitutional limitation on the ability of the Federal Government to levy any general levy of an employer's tax on State or local governments. NACo supports the optional inclusion of the public sector work force in the Social Security System and opposes any legislative efforts to extend coverage mandatorily to the public sector. NACo opposes efforts to bar, limit, or inhibit the voluntary withdrawal of local and State governments from the Social Security System when withdrawal is deemed by local elected officials to be in the best interests of their respective county, municipal, or State governments. NACo supports efforts by the Congress to improve the Social Security System so that withdrawal will be less necessary or attractive; but, the option for withdrawal should remain as is under current law.

Current Government statistics show a creeping trend toward withdrawal from the system. For the 18-year period 1959 through 1977, 401 State and local units of government, representing 54,000 employees, have withdrawn from social security. Pending termination requests through December, 1978, cover 325 additional State and local governments, representing 505,726 employees including the city of New York and the State of Alaska. New York and Alaska, however, are reportedly expected to withdraw their termination request (a notice to withdraw can be terminated any time during the 2-year period before withdrawal actually occurs).

A number of units withdrawing from the system have cited the financial burden of participation as the principal reason for their action. The recession and the terrible impact of inflation upon State and local budgets has been, and will continue to be, the basis for these financial problems.

The 1976 annual report of the Board of Trustees of the Federal Old Age and Survivors' Insurance and Disability Insurance Trust Funds indicated on page 65 that the termination of coverage of any large number of State and local government employees would have an adverse effect on the trust funds, especially in the short range.

NACo believes that greater withdrawals from the Social Security System which might result from changes in funding of that system should receive close

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[1] NACo is the only national organization representing county government in America. Its membership includes urban, suburban, and rural counties joined together for the common purpose of strengthening county government to meet the needs of all Americans. By virtue of a county's membership, all its elected and appointed officials become participants in an organization dedicated to the following goals: Improving county government; serving as the national spokesman for county government; acting as a liaison between the nation's counties and other levels of government; and, achieving public understanding of the role of counties in the federal system.

study, particularly insofar as perceptions about the integrity and character of social security as substantially an insurance system are concerned. NACo also expresses concern that any social security funding changes include language and policy which would discourage withdrawals from the system by local uints of government.

For example, the impact on both Milwaukee County and the Social Security System resulting from withdrawals by Milwaukee County's 10,000 employees would be:

(A) "Savings" to Milwaukee County of $6.8 million in social security employer's payroll taxes.

(B) A need by the county to purchase or to provide similar coverage from replacement benefit plans. This would result in the expenditure of much of the $6.8 million "saved" by withdrawal. A recent study by the special Committee on Aging indicated that such replacement plans usually cannot match the breadth of the social security coverage, especially in the areas of survivor's coverage, disability coverage, and prepaid health insurance such as provided by medicare.

NACo also expresses concern that the impact of any changes in financing for social security will weaken the insurance principle and earnings-related nature of the system and will, in doing so, actually operate to stimulate withdrawal. The line of reasoning here is that once significant general revenue funding is approved to cure financing problems in the Social Security System, current public employees may well ask "Why should we continue to finance a system from our payroll taxes and local taxpayer's pockets which will already provide us benefits without any further contributions?" NACo is trying to determine from within its membership whether such general Federal revenue payments for social security would generate such a reaction. While some States, like Wisconsin, have laws preventing withdrawal from the Social Security System by their local units of government. Many States do not have such statutes. It appears, therefore, that relevant State laws, the attitudes of county employees, the true cost of replacement plans, and how gaps in the replacement plans would be addressed. All of the above appear to be appropriate questions for congress to ask in evaluating the prospects for increased withdrawals if funding of social security is changed.

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(1) County-property taxes would have to be increased $2 million or 3 percent just to pay for the one time increase of 15 percent in the county employer's share of payroll taxes.

(2) County officials would become apprehensive that the new demands placed upon Federal revenues by the Social Security Trust Funds would decrease the amount of Federal aid available for other programs in the future.

(3) Large urban counties like Milwaukee, with stable if not shrinking tax bases, would have to lay off employees or reduce services to meet this new "mandated" Federal expense within their already limited resources.

Because the greatest growth in public employment is taking place at State and local levels, greater percentages of payroll tax funding for social security will come from contributions from State and local government employees. We must, therefore, take steps to "squelch" any stimulus to withdraw from the Social Security System, whether it results from changes in funding arrangements or from changes in benefit levels. The National Association of Counties Taxation and Finance, Welfare and Social Services, and Labor-Management Relations Policy Steering Committees will be asked to form a task force and report by letter to your committee a more thorough response of impact on counties should the administration's funding proposals for social security be adopted.

Thank you, Mr. Chairman, and members, for the opportunity to appear before this subcommittee. I will be happy to answer any questions.

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This disjointed political process has three consequences. First, citizens have difficulty understanding the social welfare system. Programs are complicated, misleading, and often incompatible. It is hard for an individual to determine his eligibilities, and impossible for him to discern a consistent rationale for those eligibilities. It is all too easy for a recipient to believe that his situation is unfair: that he is discriminated against or that others with no greater claim receive better treatment.[2] Second, many important issues of eligibility are not resolved by Congress. In effect, these decisions are delegated to federal and state administrative agencies and to the courts.[3] In the absence of legislative guidance, however, such delegation is bound to produce inconsistent results since agencies and courts have no generally accepted theoretical assumptions by which to structure the boundaries of social welfare protection.[4] Third, a desultory social welfare system tends toward permanence. Complicated, compartmentalized programs encourage tenacious defense of specific advantages. Thus efforts for evaluation and alteration are denied broad political support.[5]

We very much need theories of welfare state protection: reasons why Smith is paid and Green not, or why Smith's check comes only if he labors and Green's only after a lecture from a social worker. Some commentators, however, have argued to the contrary, contending that the lack of theoretical underpinnings permits the social welfare system to pay more to the poor than it would if programs an dtheir purposes were better understood, and that current programmatic confusion is therefore desirable.[6] But this analysis is unsound, even by its own result-oriented standards. Undisciplined social programming may help some in-

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[2] *See generally* M. Barth, G. Carcagno & J. Palmer, Toward an Effective Income Support System: Problems, Prospects, and Choices (1974); D. Moynihan, *supra* note 1, at 17–60; Subcommittee on Fiscal Policy, Joint Economic Committee, 92d Cong., 2d Sess. & 93d Cong., 1st Sess., Studies in Public Welfare (Comm. Print 1972–73); J. Handler, Reforming the Poor: Welfare Policy, Federalism, and Morality (1972); F. Wiseman, "Welfare," movie shown on National Educational Television, September 24, 1975.

[3] *See, e.g.*, Rosado v. Wyman, 397 U.S. 397, 408 (1970) (state discretio nin fixing "standard of need"); Jefferson v. Hackney, 406 U.S. 535 (1972) (state discretion in determining relative benefit levels for different programs); New York State Dep't of Social Servs. v. Dublino, 413 U.S. 405 (1973) (state discretion in determining and administering work requirements).

[4] The AFDC program in particular has generated conflicting judicial assessments of legislative purpose. *Compare* Kink v. Smith, 392 U.S. 309, 325 (1968) (Warren, C. J.), *with* Shapiro v. Thompson, 394 U.S. 618, 645 (1969) (Warren, C. J.), dissenting. *Compare* Carleson v. Remillard, 406 U.S. 598 (1972) (Douglas, J.), *with* Wyman v. James, 400 U.S. 309 (1971) (Blackman, J.). *Compare* Rosado v. Wyman, 397 U.S. 397 (1970) (Harlan, J.), *with* New York State Dept. of Social Servs. v. Dublino, 413 U.S. 405 (1973) (Powell, J).

[5] *See generally* H. Aaron, *supra* note 1, at 31–46.

[6] *See* R. Blechman, E. Gramlich & R. Hartman, Setting National Priorities: The 1975 Budget 187–89 (Brookings Inst. 1974); Wall St. J., July 3, 1975, at 6, col. 3 (interview with Gilbert Steiner, Director of Government Studies at the Brookings Institution).

dividuals, but it neglects others, and the latter group are often among those least able to fend for themselves economically, politically, and bureaucratically.[7] Incoherent programs may pay out a great deal of money, but they are politically vulnerable in times of fiscal crunch because they make satisfaction of recipients' claims a matter of charity rather than of right. Development of a principal theory of welfare state protection, therefore, is more than pursuit of the hobgoblin of consistency. It is absolutely necessary if we are to achieve fair and comprehensive income protection commitments that are secure against changing politics.

Two giant federal programs, Social Security and Supplemental Security Income (SSI), provide benefits to persons permanently and totally disabled.[8] Within each of these statutory schemes, *a finding of "disability" serves the function of admitting a recipient to a favored status in the welfare state.* Therefore, the conditions of qualification imposed by Congress, the Social Security Administration, and reviewing courts should tell us something about our ideas of desert and priority in social welfare protection. By examining how these three institutions have defined disability, and have thereby drawn the boundaries of coverage and eligibility under the two statutes, this Article explores the principles that underlie our social welfare system. These principles are then applied in an attempt to delineate boundaries more appropriate than those that now define the Social Security and SSI welfare estates.

I. SOCIAL SECURITY DISABILITY

"Social Security" was established in 1935.[9] A payroll tax, with proceeds earmarked for a trust fund, was imposed on employees and employers.[10] By 1940,

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[7] To the extent that rules and procedures are complicated, those with greater ability or will to master the system obtain more funds. To the extent that results vary capriciously, those who can influence unprincipled political decisions do best. To the extent that unchecked discretion is lodged in bureaucrats, those who can pressure them prevail. Thus, those who cannot deal with bureaucracies are treated badly even by the one system which purports to be concerned with them. *See* M. Barth, G. Carcagno & J. Palmer, *supra* note 2; Subcommittee on Fiscal Policy, Joint Economic Committee, Studies in Public Welfare, Paper No. 5, Part I, "Welfare—An Administrative Nightmare" (Comm. Print 1972); Liebman, *Social Intervention in a Democracy*, 34 The Pub. Interest 14 (1974).

[8] *See* 42 U.S.C. § 423 (1970) (Social Security disabiilty program); *id.* §§ 1381–85 (Supp. III, 1973) (Supplemental Security Income for the Aged, Blind and Disabled). In fiscal year 1974, approximately 3,700,000 persons received more than 7.5 billion dollars in Social Security disability benfits, *see* Mathews v. Eldridge, 44 U.S.L.W. 4224, 4226 n.1 (U.S. Feb. 24, 1976); 38 Soc. Sec. Bull. 31 (1975), and another 1,300,000 received approximately 1.8 billion dollars in SSI benefits by reason of disability or blindness, *see* N.Y. Times, Feb. 27, 1976, at 32, col. 2.

[9] Social Security Act, ch. 531, 49 Stat. 620 (1935) (codified at 42 U.S.C. §§ 301–06 (1970). On the origins of the Social Security program, see 3 A. Schlesinger, The Age of Roosevelt: The Coming of the New Deal 297–315 (1959); E. Witte, Five Lectures on Social Security (1951); A. Altmeyer, The Formative Years of Social Security (1966).

[10] Social Security Act, ch. 531, tit. VIII, § 801, 49 Stat. 636 (1935) (tax on employees of 1 percent of wages, escalating in steps to 3 percent after 1948); *id.* tit. IX, § 901, 49 Stat. 639 (1935) (similar tax on employers). The term "trust fund" was first employed in the Social Security Act Amendments of 1939, tit. II, ch. 201, 53 Stat. 1362 (1939). Social Security is actually two programs, one that taxes and one that spends. In a neat sleight of hand, President Roosevelt took both to the public as one arrangement, an image essential to the message that the program was like a contract, and that individuals were depositing funds for their own later need. The legislation was drafted in an atmosphere of concern about Supreme Court review of the program, fueled by the Court's earlier invalidation of the railroad retirement scheme, *see* Railroad Retirement Bd. v. Alton R. R., 295 U.S. 330 (1935). The Committee on Economic Security, which prepared the legislation, concluded that Social Security's chances would be increased if its taxing and pension-paying components could be bifurcated. At least some evidence for this prediction came from a reliable source:

> In 1934, when Frances Perkins had confided to Justice Stone her worries about the constitutionality of a social security system. Stone Whispered back, "The taxing power of the Federal Government, my dear; the taxing power is sufficient for everything you want and need."

3 A. Schlesinger, The Age of Roosevelt: The Politics of Upheaval 398 (1969). This was not the only advisory opinion on Social Security. *See* Roosevelt & Frankfurter: Their Correspondence 1928–1945, at 224 (M. Freedman ed. 1967) (letter from Tom Corcoran and Ben Cohen in Washington to Frankfurter in Oxford, June 18, 1934: "With Ray[mond Moley]'s help we managed to have the President call in Isaiah [Justice Brandeis] on Isaiah's last day here, to discuss the social insurance message before it became public . . . .").

However informed, the strategy succeeded. The Supreme Court upheld the taxing and pension programs on the same day. Steward Mach. Co. v. Davis, 301 U.S. 548 (1937) (tit. IX): Helvering v. Davis, 301 U.S. 619 (1937) tit. VIII).

persons who had worked enough days under Social Security to "earn" a pension began to retire.[11] Each month retirees received "insurance proceeds," although of course the early recipients received far more than their own contributions, and were paid with the taxes levied on persons still working.[12] From its inception, the Social Security retirement program has exhibited two general—and not entirely compatible—characteristics. On the one hand, certain features of the program, such as the relation of retirement benefits to wages earned during an individual's working years [13] and the continued eligibility for benefits of retired persons with substantial assets,[14] reflect an insurance theme. On the other hand, Social Security has attempted to assure a minimum income for aged citizens, for example by setting a benefit floor regardless of prior wages [15] and by providing additional benefits for spouses.[16]

Social Security has thus been both an enforced individual savings plan and a redistributive minimum-income welfare program.[17] Nevertheless, the government has worked hard and successfully to persuade citizens that Social Security is insurance that has been earned and paid for by those who receive benefits. There is no conceivable doubt that responsible public authorities wished citizens to rely, emotionally and practically, on the future availability of Social Security benefits,[18] even though Congress inserted statutory language reserving the power

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[11] Between 1936 and 1940, persons who retired received a lump sum payment that was in effect the return of the Social Security taxes that they and their employers had paid. Social Security Act, ch. 531, § 204, 49 Stat. 624 (1935). Initial retirees in 1940 had to have earned $2,000 at covered employment on no less than five work days in five different calendar years. *Id.*, ch. 531, §§ 210(c)(2)–(3), 49 Stat. 625 (1935). Eligibility now depends on having worked sufficient "quarters" at covered employment, a concept introduced in 1950, *see* Social Security Act Amendments of 1950, ch. 809, § 213, 64 Stat. 504–05 (1950). A "quarter" is three consecutive months during which an individual earns covered wages of $50 or more. *Id.* (codified at 42 U.S.C. § 413(a)(2) (1970)).

[12] Social Security keeps records on earnings and tax payments credited to individual workers, but it has never had separate cash payout accounts for each wage earner. At the outset, the Administration had to devise a financial accommodation that would permit larger payments to retirees in the early years than their short participation in the program could justify. The Economic Security Committee's original plan was for the government to "borrow" these early-year taxes in order to make immediate benefit payments, and then repay the loan with interest beginning in the 1960's, but Roosevelt insisted that the infusion of general revenue (in effect paying back the original loan) be postponed until 1980. *See* Twentieth Century Fund, Report on Old-Age Security (1938); A Altmeyer, *supra* note 9 at 11–26. In 1950, the bookkeeping fiction of carrying the early "loans" with interest was dropped. Today the trust fund is at best a reserve against brief economic calamity (it contains enough money to pay benefits for only a few months if no new revenues are received), and a political safeguard for Social Security revenues against competition from other spending opportunities (no different, in that sense, from the highway trust fund). The fact that early retirees received benefits financed by funds "borrowed" from the Social Security system suggests a possible handle for appropriating general revenues to Social Security without disabusing the public of the "insurance" analogy. *See Hearings Before the Senate Special Committee on Aging,* 93d Cong., 1st Sess., pt. 4, at 252 (1973) (testimony of HEW Secretary Cohen) (advocating possible "Government subsidy" for "the deficit . . . accrued during the transition period" to avoid having people think of Social Security "as a welfare program").

[13] *Compare* 42 U.S.C. § 415(a) (Supp. III, 1973) (computation of "primary insurance amount" on basis of "average monthly wage"), *with* Social Security Act, pt. II, ch. 531, § 202, 49 Stat. 623 (1935) (old age benefit payments based on "total wages"). As of December 10, 1975, a singlep erson whose average yearly wage for 19 years before retirement was $5,500 receives $304.70 in monthly Social Security benefits.

[14] But earned income before the age of 72 results in diminished Social Security benefits. 42 U.S.C. § 403 (1970).

[15] *Id.* § 402(m).

[16] *Id.* §§ 402 (b)–(c).

[17] The argument that Social Security can best be understood as a "tax transfer" program rather than as an "insurance purchase" program was first advanced by Paul Samuelson in *An Exact Consumption-Loan Model of Interest With or Without the Social Contrivance of Money,* 66 J. Pol Econ. 467 (1958). *See also* J. Brittain, the Payroll Tax for Social Security (1972); Campbell, *Social Insurance in the United States: A Program in Search of an Explanation,* 12 J. Law & Econ. 249 (1969).

Those who believe that Social Security as packaged and operated has been immensely successful are obliged to acknowledge the accuracy of his description, but they remain passionate that moves to make the reality—that Social Security is a tax transfer program and not an aggregation of personal insurance policies—more visible would be a mistake. *See, e.g., Hearings Before the Senate Special Committee on Aging, supra* note 12, at 251–52 (testimony of former HEW Secretary Cohen).

[18] "The hope behind this statute is to save men and women from the rigors of the poor house as well as from the haunting fear that such a lot awaits them when journey's end is near." Helvering v. Davis, 301 U.S. 619, 641 (1937) (Cardozo, J.).

Among the public expressions that accompanied inception of Social Security, the following are typical:

"A Federal old age insurance system, the largest undertaking of its kind ever attempted, has been organized and under it there have been set up individual accounts covering 42,500,000 persons who may be likened to the policy holders of a private insurance company."

(Continued)

to change the program.[19] Sensible citizens have relied on these official promises in determining the extent of private provision it is reasonable for them to make.[20] For its part, the government has rarely disappointed these expectations.[21] The most recent congressional initiative was a 1973 law that provided for automatic increases in benefit levels to keep pace with inflation.[22] This provision is presumably revocable, and thus no more significant than prior ad hoc increases which normally exceeded the rise in the cost of living.[23] Yet by its very existence the escalator clause gives citizens additional practical encouragement to plan for retirement in expectation of Social Security benefits undiminished by price increases.

In the late 'forties, the Truman Administration fought and lost a battle to add compulsory health insurance to the Social Security program.[24] Meanwhile, the Social Security trust fund grew, because the actuarial assumptions of the program's draftsmen proved conservative.[25] When it became clear in 1953 that the Eisenhower Administration would not seek to abolish Social Security,[26] residual demand for health insurance and the assurance of trust fund solvency generated proposals for Social Security protection against income loss due to serious medical disability. The first success was 1954 legislation preserving the Social Security work record of disabled persons: individuals who became disabled were made eligible for retirement benefits at 65 as if they had continued to work between the onset of the disability and age 65.[27] In 1956, Congress provided that Social

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(Continued)

A Message Transmitting to the Congress a Report of the Social Security Board Recommending Certain Improvements in the Law, Jan. 16, 1939, 1939 The Public Papers and Addresses of Franklin D. Roosevelt 77 (1941).

"The Act provides for two kinds of insurance for the worker.

"For that insurance both the employer and the worker pay premiums, just as you pay premiums on any other insurance policy. Those premiums are collected in the form of the taxes you hear so much about.

"The first kind of insurance covers old age. Here the employer contributes one dollar of premium for every dollar of premium contributed by the worker; but both dollars are held by the Government solely for the benefit of the worker in his old age.

"In effect, we have set up a savings account for the old age of the worker. . . .

"These propagandists [employers who oppose Social Security] . . . are driven in their desperation to the contemptible, unpatriotic suggestion that some future Congress will steal these insurance funds for other purposes. If they really believe what they say in the [literature being inserted by employers in workers'] pay envelopes, they have no confidence in our form of government or its permanence. It might be well for them to move to some other nation in which they have greater faith."

Campaign Address on John Mitchell Day at Wilkes-Barre, Pa., Oct. 29, 1936, 1936 The Public Papers and Addresses of Franklin D. Roosevelt 548 (1938).

A similar theme permeated the program's early public literature. *E.g.,* U.S. Comm. on Economic Security, What the Economic Security Program Means To You (1935). J. Douglas Brown, writing of his service on the staff of the Commitee on Economic Security, has said: "[W]e wanted our government to provide a mechanism whereby the individual could prevent dependency through his own efforts." Brown, *The American Philosophy of Social Insurance,* 30 Soc. Serv. Rev. 1, 3 (1956).

[19] The statute reserves to Congress "[t]he right to alter, amend, or repeal any provision. . . ." 42 U.S.C. § 1304 (1970). This reservation of power underplay the Supreme Court's decision in Flemming v. Nestor, 363 U.S. 603 (1960), which held that Congress violated no constitutional requirement when it changed the Social Security law to deny benefits to a person deported for having been a member of the Communist Party, even though the person belonged to the Party and paid Social Security taxes when there was no such provision.

[20] Many private pension plans are integrated with Social Security. Contributions and payments drop as Social Security taxes and benefits increase. *See, e.g.,* Retirement income Plan for Hourly Employees of Harvard University 6–8, 12 (1975). For evidence that retirement saving is substantially less than it would be without Social Security, see Feldstein, *Social Security, Induced Retirement, and Aggregate Capital Accumulation,* 82 J. Pol. Econ. 905 (1974).

[21] *See, e.g.,* Gambill v. Finch, 309 F. Supp. 1, 2 (E.D. Tenn. 1970) (discussing the few technical amendments that have reduced coverage.

[22] 42 U.S.C. § 415 (Supp. III, 1973). Actually, Social Security benefits now respond both to wage increases (part of which are merely inflation) and again to inflationary changes specifically. This "double indexing" will before very long force gigantic tax increases, and a major transfer of income from workers to retirees. Methods for correcting what is probably a legislative error are discussed in the Report of the Quadrennial Advisory Council on Social Security, H.R. Doc. 94–75, 94th Cong., 1st Sess. (1975) [hereinafter cited as Advisory Council Report]. *See also* Feldstein, *Toward a Reform of Social Security,* 40 The Pub. Interest 75 (1975).

[23] *See* N.Y. Times, April 8, 1973, § 6, at 86, col. 6; *id.* Sept. 7, 1973, at 44, col. 1.

[24] *See* 2 H. Truman, Memoirs: Years of trial and Hope 17–30 (1956).

[25] 1953 HEW Ann. Rep. 29.

[26] *See* A. Altmeyer, *supra* note 9, at 227–28.

[27] Social Security Amendments of 1954, ch. 1206, § 106(d), 68 Stat. 1080. The so-called "disability freeze" is still part of the law, *see* 42 U.S.C. § 416(i) (1970), *as amended,* 42 U.S.C. § 416(i) (Supp. III, 1973)), and most disability cases concern claims both for current disability payments and for disability freeze protection against later reduction of retirement benefits because of the period out of work.

Security taxpayers between 50 and 65 years of age who became permanently and totally disabled should be eligible for monthly benefits as if they were already 65 and retired.[28] In 1960, the age-50 requirement was removed.[29] Disability insurance payments, thus annexed to the Old Age and Survivors program, are conditioned on three important findings. A claimant is required to show (1) that he has worked at covered employment for the requisite number of quarters; (2) that his inability to work is "medical" in nature; and (3) that he is totally disabled. An examination of these eligibility requirements illuminate basic questions about the appropriate scope of the Social Security disability program.

A. The prior work requirement

By requiring that a disability insurance recipient have worked at covered employment for a specified number of quarters,[30] the Social Security disability program imposes a test that, at first glance, seems to measure a claimant's willingness to work for a living. Such a view is superficial, for it fails to explain why one who has achieved a place in the economic structure and is then medically incapacitated deserves income support more than one who is born medically unable to obtain an economic place. The person born disabled could be just as willing to work, but he will never be eligible for Social Security disability benefits. Disability is simply bad luck, yet our system accords better treatment to those who are unlucky later in life than to those who were never lucky.

A first step toward a consistent explanation of the prior work requirement is to note its relation to the insurance aspect of Social Security. The requirement ensures that the claimant has paid the Social Security tax for a significant period. Thus benefits can be characterized not as public charity but as a return of insurance proceeds to the disability claimant who has paid tax "premiums" to purchase protection against the risk of disability. The insurance concept is not an entirely satisfactory explanation for the prior work requirement, however, for it could as easily justify coverage for all those now excluded by the requirement. We could assume that all persons undertake to pay insurance premiums if and when they work, and that the promise to pay these premiums is consideration for an insurance contract by which society agrees to protect against the possibility that an individual will become disabled after working and paying taxes, or be disabled throughout his life and so never achieve a status of taxpaying productivity. That this societal insurance concept has not been adopted indicates that we may be unwilling to regard as insurance a scheme that does not require a connection between an individual's actual contributions and the benefits he will receive.

A second possible reason for the prior work requirement could be a desire to protect the fisc against worker temptations to indolence. No empirical data support the conclusion that one who has worked will be less likely than one who has not worked to prefer a disability pension to a job.[31] Such a proposition is not implausible, however, and is the sort of collective hunch on the basis of which social welfare decisions are often made.

A third explanation of the prior work requirement would be to see it as embodying a judgement that the person who has worked before becoming disabled has a stronger claim to benefits than the person who has not worked at all. This belief could not be based solely on the sad accident of the disabling event, which would evoke equal sympathy regardless of timing; but it could be grounded on the notion that personal expectations and reliances are established with one's place in the workforce, and that it is significantly more disturbing to be struck

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[28] Social Security Amendments of 1956, ch. 836, § 223, 70 Stat. 815.

[29] Social Security Amendments of 1960, Pub. L. No. 86–778, tit. IV, § 401, 74 Stat. 967. A claimant must have worked for 20 of the prior 40 quarters. If the disability occurs before age 31, the claimant must have worked during half of the quarters since his 21st birthday, but in no event less than 6 quarters. 42 U.S.C. § 423(c)(1)(B) (Supp. III, 1973).

[30] 42 U.S.C. § 423(c)(1)(B) (Supp. III, 1973). Actually, widows and widowers can receive disability benefits based on their spouse's Social Security tax payments after age 50, even if they have not worked. *Id.* § 402(e)(1)(B)(i) (1970). Children of qualified workers are also covered if they become permanently disabled before age 18. *Id.* § 402(d)(1)(G) (Supp. III, 1973). Social Security disability thus covers some persons who may not have "declined" from a level of labor force participation. These ancillary provisions raise issues much like those now arising under SSI disability, discussed at pp. 855 67 *infra.*

[31] Results of the New Jersey negative income tax experiment can be read as mildly relevant data to the contrary. For example, the measured "willingness to work" seemed to vary very little according to a person's income level or prior work experience. *See* Work Incentives and Income Guarantee (J. Pechman & P. Timpane ed. 1975). *See also* L. Goodwin, Do the Poor Want to Work? (1972).

from one's station than to be prevented from ever reaching it.[32] Such a view would be based on the assertion that even if an individual has claims against society that are good despite his inability to make an economic contribution, as he begins to contribute he not only adds to his basic claim but also establishes a claim greater than the extent of his contributions—a claim, for example, to be protected if medical events outside his control make further contributions impossible.

No single theory can fully explain the prior work requirement. Given the payroll tax method of financing Social Security, the prior work requirement undoubtedly is linked to the insurance aspects of the program: part of total worker compensation is set aside to protect those who become disabled. The requirement is also related to work disincentive fears: an individual who satisfies the requirement has proved his willingness to labor. And the requirement accords special significance to the economic expectations generated when an individual holds a job for a substantial period of time. But at base the concept of desert implicit in the prior work requirement is the idea that in our society, although one's place is not fixed at birth or even upon completion of formal education, there should be a point at which one's station is relatively fixed—or fixed against certain unpleasant eventualities—and that a specified period of workforce participation ought to be the fixing point.[33]

B. The requirement of "medical" disability

A claimant who meets the prior work requirement satisfies a basic condition imposed on all Social Security recipients: substantial workforce participation. To qualify for disability insurance benefits, the claimant must also demonstrate that his inability to obtain work is a result of "medically determinable" illness or injury.[34] The medical disability requirement means that workers are not insured against unemployment caused by declines in capacity or willingness to work that cannot be given a medical explanation. For example, one person becomes lazy and unreliable; another ages prematurely; a third becomes surly, and can no longer perform tasks that require cooperation with fellow workers or with the public; a fourth begins to dring heavily. The qeustion thus presents itself: Why do we feel that medical disability provides a more compelling occasion for income protection than changes in individual capacity to work, when both events have the effect of ending the opportunity to earn?

The medical disability requirement obviously expresses some special solicitude for the sick. But this concern may only reflect the feeling that those who are "sick" have suffered an involuntary decline in working capacity. From this perspective, the medical disability requirement becomes an attempt to draw a line between voluntary and involuntary unemployment. We are prepared to support an individual whose workforce participation terminates after even minimal achievements, but only on the theory—which the prior work itself reflects—that disability benefits replace income which the worker expected to receive from his job, and are not an alternative to work. Thus the medical disability requirement enforces an iron logic: those who can work must work.

Courts reflect a determination to disqualify those who voluntarily withdraw from the workforce when they employ language that speaks of intention and control in defining "medical" disability.[35] If the individual chose the affliction, they seem to say, he should be denied benefits. The courts are uncomfortable with this simplistic distinction between self-induced tribulations and catastrophic external events.[36] Judges know this is an age of more complex theories of psychic caus-

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[32] *Cf.* Chatman v. Barnes, 357 F. Supp. 9 (N.D. Okla. 1973) (state denied disability benefits to *children* if parents' income exceeded a specified level, but paid benefits to disabled *adults* whose own parents exceeded the same income limits).

[33] *See generally* L. Rainwater, What Money Buys (1974); C. Jencks, Inequality (1972).

[34] 42 U.S.C. § 423(d)(1)(A) (1970).

[35] *See, e.g.*, Osborne v. Cohen, 409 F.2d 37, 39 (6th Cir. 1969). Compare Marion v. Gardner, 359 F.2d 175 (8th Cir. 1966) (Blackmun, J.) (awarding disability insurance benefits where claimant, a homosexual, was hospitalized for mental illness coupled with lack of power to control his sexual impulses), *with* Pierce v. Gardner, 188 F.2d 846, 848 (7th Cir. 1967), *cert. denied*, 393 U.S. 885 (1968) (denying benefits because "the record discloses no mental illness but only a mental or personality disorder coupled with a propensity (not uncontrolled impulse) to the commission of sex offenses").

[36] A typical case is Judge Dooling's attempt to determine whether a claimant exhibited "voluntary resignation to alcoholism as an escape of choice from a life of daily labor" or, on the other hand, "helpless self-entrapment in an unconquerable addiction," Badichek v. Secretary of HEW, 374 F. Supp. 940, 942–43 (E.D.N.Y. 1974). *Compare* A. Milne, The World of Pooh 208 (1957):

"Can they fly?" asked Roo.

"Yes," said Tigger. "They're very good flyers, Tiggers are. Stornry good flyers."

"Ooo!" said Roo. "Can they fly as well as Owl?"

"Yes," said Tigger. "Only they don't want to."

ation. In addition, this version of the "medical" test does not explain how much time must have passed since the individual's choice before the consequences will be regarded as a qualifying disability. For instance, an individual may have "chosen" to begin drinking years ago, but may have become a "medically determinable" alcoholic who today cannot easily free himself from addiction.[37] But despite its simplicity and its shortcomings, the "medical" label still serves as a very rough line excluding from qualification those changes in employment status that have resulted from the individual's own choices and therefore not from a random external event.

The central difficulty with the medical disability requirement has been that persons with indistinguishable physical ailments report differing degrees of physical limitation or pain, and differ as well in the extent to which they modify their behavior.[38] The variety of individual reactions to illness and injury presents the Social Security Administration with a large number of difficult qualification questions.[39] The SSA often concludes that an individual is not medically disabled because for many other persons a similar injury or illness is compatible with work.[40] A substantial percentage of these administrative determinations are in turn reversed by the courts,[41] which have pronounced no general rules for qualification but have instead employed the technique of finding the Secretary's evidence insufficient to support a conclusion of nonmedical disability.[42]

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[37] *See, e.g.,* Wheeler v. Glens Falls Ins. Co., 513 S.W.2d 179 (Tenn. 1974) (workman's compensation case) *But cf.* Powell v. Texas, 392 U.S. 514, 550 (1968) (White, J., concurring in result):

"I cannot say that the chronic alcoholic who proves his disease and a compulsion to drink is shielded from conviction when he has knowingly failed to take feasible precautions against committing a criminal act, here the act of going to or remaining in a public place."

[38] *E.g.,* Ber v. Celebrezze, 332 F.2d 293, 296 (2d Cir. 1964) ("While the medical evidence may perhaps indicate that Mrs. Ber's physical symptoms were of a type which probably would have caused many people considerably less pain than Mrs. Ber suffered, it nevertheless amply supports her complaint that in her particular medical case these symptoms were accompanied by pain so very real to her and so intense as to disable her."); Page v. Celebrezze, 311 F.2d 757, 762–63 (5th Cir. 1963).

[39] *See* Dixon, *The Welfare State and Mass Justice: A Warning from the Social Security Disability Program,* 1972 Duke L. J. 681, 683 n.12 The difficulty of these individualized determinations was apparent to one perceptive commentator when the initial "disability freeze" law was enacted. *See* E. Burns, Social Security and Public Policy 124 (1956). It is not apparent even now to the Supreme Court. *See* Mathews v. Eldridge, 55 U.S.L.W. 4224, 4232 (U.S. Feb. 24, 1976) (Powell, J.):

"In short, a medical assessment of the worker's physical or mental condition is required. This is a more sharply focused and easily documented decision than the typical determination of welfare entitlement. In the latter case, a wide variety of information may be deemed relevant and issues of witnesses credibility and veracity often are critical to the decision-making process. . . .

"By contrast, the decision whether to discontinue disability benefits will turn, in most cases, upon 'routine, standard, and unbiased medical reports by physician specialists' ". . . .

[40] *See, e.g.,* Hayes v. Celebrezze, 311 F.2d 648, 651 (5th Cir. 1963) ("The Secretary persists in the notion that no matter how painful in fact [claimant's osteoarthritis of the spine] must be, it does not saitsfy the statute.").

[41] In 1971 there were 1,537 new disability complaints in the district courts and 1,260 "old" disabiilty cases awaiting disposition. In that year the courts of appeals decided 86 disability cases, and had 69 others pending. The Secretary was affirmed in only 62% of the 1971 district court cases. From inception of the disability program through calendar 1970, the Secretary's record in the courts of appeals was 232 affirmances and 162 reverals and remands. Dixon, *supra* note 39, at 700–01 & nn.92 & 93. *See also* Sayers v. Gardner, 380 F.2d 940, 942–43 (6th Cir. 1967): L. Jaffe. Judicial Control of Administrative Action 608 (1965). Kaufman, *District Court Review of Department of Health, Education, and Welfare Decisions,* 26 An. L. Rev. 113 (1974). The high reversal rate for disability cases has been cited both to show that the appellate system is fair. Richardson 1. Perales, 402 U.S. 389. 410 (1971) (Blackmun, J.), and to show that the initial process is dubious, Richardson v. Wright 405 U.S. 208, 221 (1972) (Brennan, J., dissenting). *See* Brudino, *Fairness and Bureaucracy: The Demise of Procedural Due Process for Welfare Claimants,* 25 Hastings L.J. 813, 826 n.41 (1974).

[42] An example is Wilson v. Richardson, 455 F.2d 304 (4th Cir. 1972), where the Secretary applied his crude rule—earnings of $140 per month show an individual is not disabled, *see* 20 C.F.R. § 404.1534(b) (1975)—even though the claimant had held and lost eleven different jobs because employers discovered his impairments or because of the strain on his back and legs. The court reversed, saying that sometimes a record of employment can establish, instead of refute, a conclusion of disability. Similar cases include Dodsworth v. Celebrezze, 349 F.2d 312 (5th Cir. 1965); Mefford v. Gardner, 383 F.2d 748 (6th Cir. 1967); Browne v. Richardson, 468 F.2d 1003 (1st Cir. 1972); Webb v. Weinberger, 371 F. Supp. 793 (N.D. Ind. 1974). These cases exhibit a modern view of how much pain and discomfort an individual must bear that is quite different from the sturdy attitude of Judge Learned Hand:

"A man may have to endure discomfort or pain and not be totally disabled; much of the best work of life goes on under such disabilities; if the insurance had been against suffering, it would have read so."

Theberge v. United States, 87 F.2d 697, 698 (2d Cir. 1937) (plaintiff's claim for benefits under war risk insurance policy should not reach jury).

The high reversal rate could be attributed to a difference in institutional perspectives. The Secretary runs a large program, and must have rules. Attempting to implement Congress' clear purpose that benefits be provided only to those persons in fact medically disabled, the Secretary establishes hurdles that make it difficult for someone to qualify solely on the basis of a persistent assertion that he is physically incapable of work or able to work only with great pain.[43] Judges, on the other hand, need not consider the program as a whole or its annual budget. Their inquiry is normally focused on an individual claimant, whose story is often sympathetic, whose perseverence in carrying the case so far is evidence of a sincere claim, and who will not be on Easy Street even if he wins the appeal.[44]

The conflict between the Secretary and the courts on the medical disability issue exposes a broader disagreement about the nature and purpose of the Social Security program. The Secretary's Procrustean rules achieve a certain sort of fairness by regularizing discretionary determinations. From his perspective, if most persons will respond in a certain way to a particular injury or illness, then it is appropriate to assume that everyone will respond in that way. The courts have taken a contrary position that is more responsive to the insurance aspects of Social Security. Their insistence that the Secretary produce better evidence to rebut individual disability claims can be seen as a determination to interpret the program's content with attention to the expectations individuals have formed as they have participated in an on-going relationship with the United States. Relying on the government's promise of disability benefits, citizens have forsaken alternative savings arrangements.[45] The individual worker believes he is protected against medical catastrophe. To him that means he will receive income-support payments if *he* is sick or hurt and can no longer work. He certainly does not expect that an injury which disables *him* will be found noncompensable (i.e., nonmedical) because most persons would be able to continue working with symtoms that are indistinguishable to the doctors' methods and machines.

The courts' concern for individual worker expectations is fully consistent with the history and conduct of the Social Security disability insurance program. When a judge reverses a denial of benefits, he should be seen as saying that the program's purpose is to assure income related to prior earnings when a claimant can make a sufficient showing of certain sorts of random bad luck, and that the showing made by the claimant is sufficient, in that most persons (1) would want to be covered if they could make such a showing; (2) would expect a disability insurance program to cover them in such circumstances; and (3) are prepared to pay the costs of coverage for all such cases as are likely to arise. This focus on the reasonable expectations of Social Security participants suggests the need for fact-finding procedures open to allegations of pain;[46] to assertions that a physical accident has led to changes in personality so drastic as to prevent effective work;[47] and to claims that an individual is disabled even if he declines a dangerous and frequently unsuccessful operation.[48] The central characteristics of Social Security disability insurance should be a claimant's climb to a place in the labor force, his loss of that place due to one of a category of external risks we have decided to spread among all workers, and his current inability to achieve income without a degree of effort or suffering that persons generally would regard as unnecessary

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[43] *See, e.g.,* Butler v. Flemming, 288 F.2d 591 (5th Cir. 1961) ("[c]laimant could no longer even shuffle dominoes," yet Secretary denied benefits).

[44] "Reversals seem to be a complex of (1) the inherently amorphous nature of the abstract capacity-for-gainful-activity standard when applied to claimants with some quantum of residual work capacity; (2) the borderline fact situations in most of the cases which fall outside [per se rules]; (3) the difficulty in assessing psychological overlay in the borderline cases; (4) the conclusory testimony of some medical advisers, which has telling effects; (5) the naturally appealing nature of the face-to-face contact, which first occurs at the hearing examiner level; (6) the presence of an attorney who in any borderline case can always make a plausible argument, and by his mere presence threatens further appeal; (7) the natural desire of an appellate body to exercise its independence, which in the SSA context can only be accomplished through ruling in favor of the claimant; (8) at the court level, judicial ignorance or simply nonacceptance of the statutory standard of disability."

Dixon, *supra* note 39, at 732–33 n.259. Of course, one thing the history of public disability insurance may show is that there are some legislative distinctions that, even if they accurately describe the categories popular perceptions would define, are extremely hard to administer cheaply and fairly.

[45] *See* pp. 838, 39 and nn.18–20 *supra*.

[46] *See* Ber v. Celebrezze, 332 F.2d 293 (2d Cir. 1964).

[47] *See* Davidson v. Gardner, 370 F.2d 803 (6th Cir. 1967).

[48] *See* Morse v. Gardner, 272 F. Supp. 618 (E.D. La. 1967).

for someone with this individual's thresholds of pain and discomfort.[49] These are exceedingly individualized determinations, to be sure, but they are necessary if this program is to perform its appropriate task.

C. The total disability requirement

Even if a claimant has worked for the required number of quarters and has suffered a "medical" decline, benefits will be denied unless the fall from employability is total.[50] For example, a skilled auto mechanic whose rheumatism makes him unable to repair cars but who is still capable of performing a sedentary occupation is not covered. The statute does not insure against his decline in income,[51] nor does it offer him the option of subsisting on a disability grant or taking a lower paying job.[52] Because the claimant can work, he must work.

Although the Social Security statute defines total disability as "inability to engage in any substantial gainfun activity by reason of any medically determinable physical or mental impairment," [53] some workers are classified as totally disabled with no inquiry into whether they can work at other jobs. Loss of both arms or both legs, for example, is a per se case of total disability according to the Secretary's regulations.[54] But unless a claimant is unlucky enough to have lost a large chunk of his anatomy, he can qualify only by showing that, in his specific case, a medical impairment has brought him within the statutory standard of inability to perform "substantial gainful activity."

1. Reasons for the Total Disability Requirement.—Two ideas compete for priority in the Social Security program. One is need. Because one of the program's purposes is to prevent destitution, it inevitably strains to conserve limited resources for allocation among the most needy. This concern for prudence not only mandates efficient identification of the most needy. It also mandates equity; an inquiry into the relative claims of possible recipients. The second concept is insurance. The government's representations have generated expectations and reliances by working persons, and the program must redeem its promises so that its ongoing commitments will be credible. The total disability requirement shows the complex interplay of these two concepts in a program plainly attempting to respond to both of them.

The total disability requirement certainly implements an intention to allocate limited resources to the most needy. Those who cannot work need more assistance than those able to obtain a job, even though it pays less than their former employment. Denial of benefits for partial disabilities also conserves resources by avoiding the substantial cost of ascertaining the precise extent of a partial disability. But efficiency is always with us, providing a reason for doing less rather than more. And Social Security is not the only potential source of support for the completely disabled. Other programs—such as general relief or AFDC—identify their beneficiaries principally in terms of need. Therefore, neither administrative efficiency nor an attempt to assist the most needy can fully explain (1) why Social Security disability denies benefits to those only

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[49] Emphasizing this explanation for the Social Security disability program casts doubt on one group of cases in which the judges have been moved to overrule administrative denials of benefits. Sometimes, an individual is physically or mentally impaired from the beginning of his working life, but manages to accumulate the very brief work experience (theoretically, as little as $300 in covered wages, over a period of eighteen months, *see* note 11 *supra*) required for Social Security coverage. If this person then applies for benefits, but cannot show that his condition has deteriorated, the theory of the program advanced above would suggest denial. Courts usually look only at the condition of the person as he appears before them, and at the technical requirements for achieving coverage. If the person now seems impaired, they are likely to reverse a denial of benefits even if the person was no healthier when working. *See, e.g.*, Rayborn v. Weinberger, 398 F. Supp. 1303 (N.D. Ind. 1975).

[50] 42 U.S.C. § 423(d)(2)(A) (1970).

[51] *But see Hearings Before the Senate Special Committee on Aging*, 93d Cong., 1st Sess., pt. 4, at 246 (1973) (suggestion by former HEW Secretary Cohen that persons over 55 who are able to work but "unable to engage in their customary occupation" be covered).

[52] *But cf.* Stewart v. Cohen, 309 F. Supp. 949, 955 (E.D.N.Y. 1970) (suggesting that college-educated claimant might be permitted to receive benefits during a limited period of rehabilitation and training, instead of being required to accept employment as unskilled laborer, so he could again be qualified for white-collar employment).

[53] U.S.C. §423(d)(1)(A) (1970).

[54] *See* 20 C.F.R. § 404.1502(c) (1975); United States Department of HEW, Social Security Administration, Disability and Social Security (1965). Qualifying injuries and illnesses are listed in 20 C.F.R. ch. III, subpt. P, app. (1975). For evidence that Congress has approved qualification on the basis of such "pure" medical determinations, see Dixon, *supra* note 39, at 704 n.110.

partially disabled, or (2) why we pay those who are totally disabled with relatively generous Social Security checks rather than with AFDC or general relief grants. A totally disabled person who has never worked, or a person whose alleged total disability is not medically cognizable, may be just as needy as a Social Security disability recipient—yet we tell him to look elsewhere for income protection.[55]

It is tempting to see the total disability requirement as an exemplification of a principle of equity. In our economy, some individuals must perform disagreeable and low-paid jobs. Since a partially disabled person can by definition perform at least this sort of job, it may be thought to be inequitable to treat him as having a claim on society greater than that of a person who has always worked at a lesser-paying job. Thus, if we focus only on need, it may seem unreasonable to differentiate between similarly situated persons merely because one has suffered a partial medical disability.

The difficulty with this argument from equity is that we pay benefits to those "totally" disabled for a medical reason who have satisfied the prior work requirement, but not to persons unable to work who have never worked or whose difficulty is not "medical." The very existence of the Social Security disability program is an assertion that the person whose employment history shows a medical decline from earlier achievement deserves benefits more generous and less burdened by bureaucratic indignities than the person who has not previously worked. The disabled person has been encouraged to think of the Social Security taxes deducted from his wages as a purchase of insurance against income loss from medical catastrophe. That the disabled claimant is no worse off than some who clearly have no Social Security claim is irrelevant: it is prior work and medical catastrophe, not level of need, on which the disabled person urges his right to Social Security. Because Social Security has such a substantial insurance component—responding to an individual's personal work record, to the expectations created by employment, and to the particular causes of his present difficulties—arguments based solely on equitable treatment of those currently in similar economic circumstances cannot fully explain the program's basic rules or provide sufficient guidance in resolving the ambiguities of the statute.

Thus no logic *requires* that the Social Security program deny protection against partial declines in earning power. The program excludes these declines because funds are limited and because the exclusion avoids a category of difficult administrative determinations. Denying benefits for partial disability is acceptable, however, because official messages have always made clear that only "total" disability will be compensated.

2. *The Job Gap Cases.*—The tension, implicit in Social Security, between providing income support for an equitably defined subgroup of the needy and satisfying the officially encouraged expectations of wage-earners, is best illustrated in the "job gap" cases. An individual enters the job gap when he suffers an unquestioned medical disability that prevents continuation of pre-injury employment, when he remains physically and emotionally able to do certain other jobs, but when he cannot obtain another job. Jobs may be unavailable because: (1) they do not exist where the claimant lives;[56] (2) employers incorrectly conclude that the disability prevents performance of the job;[57] or (3) employers hire non-disabled persons who are younger, or abler, or safer risks.[58] Such a worker is medically disabled; the disability is a but-for cause of his unemployment; and yet his disability alone does not keep him from working. It is disability as well as labor market conditions that have left him unemployed.

The first extended analysis of the job gap problem appeared in the influential case of *Kerner* v. *Flemming*.[59] Kerner had been a self-employed furniture repairman. After suffering a heart attack and serious diabetes, he could only do "light,

[55] *See* Coleman v. Gardner, 264 F. Supp. 714, 718 (S.D.W. Va. 1967):

In this instance, plaintiff's youth and sketchy work record mitigate [sic] against his cliam The Act's disability provisions are designed primarily to aid workers who, after having made a contribution to the nation's work force, are unable to continue. It is not intended, nor should we allow it to become, a substitute for the various Federal and State direct relief programs for the socially deprived.

[56] *E.g.*, Wright v. Gardner, 403 F.2d 646 (7th Cir. 1968).

[57] *See, e.g.*, King v. Gardner, 391 F.2d 401, 404–05 n.7 (5th Cir.) (dictum), *vacated on rehearing*, 391 F.2d 401, 410-11 (5th Cir. 1967) (en banc).

[58] *E.g.*, Caraballo v. Secretary, 346 F. Supp. 93 (D.P.R. 1972).

[59] 283 F.2d 916 (2d Cir. 1960) (Friendly, J.).

sedentary work."[60] His willingness to do such work was unquestioned. To the extent jobs were available, however, employers chose not to hire a 60-year-old diabetic with a history of heart disease. The Secretary denied benefits, but the Court of Appeals for the Second Circuit reversed. Judge Friendly interpreted the disability requirement as follows: What can applicant do, and what employment opportunities are there for a man who can do only what applicant can do."[61] *Kerner* gradually received wide,[62] though not universal,[63] assent. Courts placed on the Secretary the burden—once a claimant showed a disability making him unfit for his former work—of producing evidence sufficient to show not only what work the claimant was still capable of performing, but also that obtaining such work was a realistic possibility, and realistic near the claimant's home.[64]

Only Judge Wisdom, in a perceptive dissent from Fifth Circuit agreement with *Kerner*,[65] recognized the potential application to job gap cases of a principle of equity that would justify exclusion from the program of those who are only partially disabled. He acknowledged the economic distress of medically impaired persons in the job gap, but contended that it was not distinguishable from the need of every non-disabled person in the job gap. Non-disabled persons who cannot find work, Judge Wisdom argued, must rely on unemployment insurance or, when that expires, on general public assistance, and he found neither equitable nor statutory authority for treating medically impaired persons any differently.[66]

But Judge Wisdom's position does not differentiate among the needy, or among the programs we have established to assist them. Because he considered Social Security disability benefits to be no more than a general relief dole, and to be unaffected by the program's insurance image and its role in framing worker expectations, Judge Wisdom saw no inconsistency in asking why a worker cannot get a job now without inquiring as to why he lost the job he had. No doubt Congress did not mean to pay disability benefits to a worker who loses his job because of automation or a demand contraction: the medical disability requirement is proof of that. Yet in arguing against *Kerner*, Judge Wisdom ignored the fact that except for a medical misfortune, the job gap claimant would have been working. Furthermore, Judge Wisdom's position proves too much. It is, of course, based on the assumption that Mr. Kerner *can* work, but virtually every disabled person can do something for which another person will pay. He is "totally" disabled because the market value of his labor, given such alternatives as machines and healthy persons, is so low. Indeed, disability is as much a function of social choices as it is a result of illness or injury. We impose—arbitrarily, but sympathetically and wisely—a barrier that says, "Work less valuable than this price shall not be done for money in this society. If that is all you can do, it is better that you be regarded as unemployed or disabled." Thus, Mr. Kerner could

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[60] *Id.* at 918.

[61] 283 F.2d at 921. Kerner himself apparently did not benefit from his doctrinal victory. *See* Kerner v. Celebrezze, 340 F.2d 736 (2d Cir.), *cert. denied,* 382 U.S. 861 (1965).

[62] *See, e.g.,* Baker v. Gardner, 362 F.2d 864 (3d Cir. 1966); McMuller v. Celebrezze, 355 F.2d 811 (9th Cir. 1964), *cert. denied,* 382 U.S. 854 (1965); Torres v. Celebrezze, 349 F.2d 342 (1st Cir. 1965).

[63] *See, e.g.,* Loftis v. Ribicoff, 193 F. Supp. 469 (W.D. Mo. 1961).

[64] An extreme version of the *Kerner* issue was presented in Sayers v. Gardner, 480 F.2d 940 (6th Cir. 1967). There, claimant could not get jobs because employers said they would have an "insurance problem" if they hired her, and the court reversed the Secretary's conclusion that claimant could in fact work. Obviously, the Secretary was making one decision (whether claimant could or could not work), the employer was making a second (whether, among the candidates for some particular job, he and his workmen's compensation carrier preferred someone who had not previously been sick), and the court was making a third decision (whether a reasonable disability statute would regard this individual's reasons for being unemployed as "medical"). For an example of a decision reflecting an appreciation of actual labor market conditions, see Hanes v. Celebrezze, 137 F.2d (4th Cir. 1964). The claimant had a patronage job as custodian at a public building, but the court rejected the Secretary's conclusion that performing that job—which in fact his wife and son often performed for him—showed that he was not disabled. *Accord,* Stark v. Weinberger, 497 F.2d 1092 (7th Cir. 1974) (Stevens, J.).

[65] King v. Gardner, 391 F.2d 401, 405 (5th Cir. 1967) (Wisdom, J., dissenting). Even though Judge Wisdom failed to persuade the majority to deny benefits to King, her victory was Pyrrhic. She was ultimately denied benefits when—while her case was still being litigated—Congress adopted Judge Wisdom's position in the 1967 amendments to the Social Security Act, *see* p. 853 *infra. See* King v. Finch, 428 F.2d 709 (5th Cir. 1970).

[66] Perhaps surprisingly, the commentators generally sided with Judge Wisdom. *See, e.g.,* Rowland, *Judicial Review of Disability Determinations,* 52 Geo. L.J. 42, 79 (1963); Note, *Social Security Disability Determinations: The Burden of Proof on Appeal,* 63 Mich. L. Rev. 1465, 1472–73 (1965).

not work, and since his removal from the workforce was occasioned by medical disability, he should have received benefits.[67]

This sense of disability as society's categorization of those honorably disqualified from work is adumbrated in the pain and suffering cases, which the system normally deals with under the rubric of the medical disability requirement,[68] but which reflect an implicit judgment about total disability. The claimant alleges that a certain injury is so painful that he cannot perform any work. The Secretary concludes that, because similar injuries have not completely disabled other workers, inability to work is caused by a failure of will, and hence he labels the disability as nonmedical. When courts review those cases, their opinions express a social judgment as to whether *that* level of pain is a sufficient reason to quit work altogether.

The obvious rightness of the Secretary's per se rules for total disability—automatic qualification for a person who has lost both arms, for example [69]—alo suggests that our definition of disability incorporates common expectations and shared values about what infirmities a person *ought* not to have to bear and keep working. As to persons so disabled, we say, in essense, "No one expects you to work any longer. If this happens to you, you can stop work and receive Social Security benefits."

3. The Job Gap Statute.—The *Kerner* debate was possible because the job gap question was left open by the Social Security statute. Once a judicial consensus developed, of course, Congress might have left that consensus undisturbed. Instead, it overruled the judges who followed *Kerner*. In 1967 disability insurance was amended to provide that an impairment could not be considered a "total" disability unless it rendered the claimant unable to perform not only his previous work, but also "any other kind of substantial gainful work which exists in the national economy, regardless of whether such work exists in the immediate area in which he lives, or whether a specific job vacancy exists for him, or whether he would be hired if he applied for work." [70]

In its Report accompanying the legislation, the House Ways and Means Committee expressed "concern about the rising cost of the disability insurance program and the way the definition of disability has been interpreted." [71] Cost may have been a factor in the legislative calculus, although what was at stake was a tiny part of the entire Social Security program. Rather, at least some legislators must have felt disserved by what the Senate Finance Committee referred to as "some of the court decisions on the subject.[72] The betrayal presumably was accomplished by judicial admission to "disabled" status of individuals with inferior claims, who might just be malingering, or whose need for money—even if real—ought not to be met with checks carrying the very special dignity associated with Social Security.

4. Disappointed Expectations.—It is, of course, possible to maintain Judge Wisdom's distinction between Kerner and the person so sick that he cannot physically perform any job that pays the minimum wage, and possible, too, to regard Kerner as no different from unemployed persons whose abilities have not declined. But in light of the concepts underlying Social Security and its disability

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[67] Recognition of the attitude suggested above can be seen in the so-called "wolf from the door" cases. Occasionally under Social Security disability, courts have disagreed with the Secretary's conclusion that an individual's earnings history demonstrates that he is not disabled. The judges have said that the need to eat will force some individuals to work even though they qualify as disabled. The conclusion must be that the physical capacity to do work for which the market will pay does not establish the absence of a disability, but that at least sometimes a judgment independent of the market's can be made that the person need not work. *See, e.g.*, Flemming v. Booker, 283 F.2d 321, 324 (5th Cir. 1960); Hanes v. Celebrezze, 337 F.2d 209, 213–14 (4th Cir. 1964); *cf* United States v. Spaulding, 293 U.S. 498, 505 (1935) (World War I risk policy).

[68] *See* pp. 842–45 *supra*.

[69] *See* p. 848 & n.54 *supra*.

[70] Social Security Amendments of 1967, Pub. L. No. 90–248, § 158(d)(2)(A), 81 Stat. 868 (codified at 42 U.S.C. § 423(d)(2)(A) (1970)).

[71] H.R. Rep. No. 544, 90th Cong., 1st Sess. 28 (1967). The Senate defeated the anti-*Kerner* legislation, 113 Cong. Rec. 16,746 (daily ed. Nov. 17, 1967), but then accepted the Conference Committee's restoration of it, 113 Cong. Rec. 35,924 (daily ed. Dec. 15, 1967).

[72] *See* S. Rep. No. 744, 90th Cong., 1st Sess. 47–49 (1967).

component, *Kerner* and its progeny ought not to have been disapproved.[73] The Social Security disability program expresses not only a present willingness to support the incomes of certain needy people. It is a complex interrelated scheme, clearly intended (1) to reassure workers who fear the economic consequences of disability; (2) to enforce prudence by taxing their labor as a means of financing protection; and (3) to pay benefits as a matter of right. Social Security disability may not be a private insurance contract, but it obviously reflects a congressional purpose to create expectations and behavior exceedingly similar to what would be brought about by mandatory private insurance.

To visualize Social Security disability protection as a function of worker expectations is to see a way through the *Kerner* problem. If an individual bought private insurance against total medical disability and then became so sick that he could not do his former job, would he not expect to be paid—even if he could still perform some work but could not obtain a job? What point would insurance have, if not to pay when sickness leads to zero income? The insured might be less "needy" because of his theoretical capacity to work, but the point of insurance woud surely be income continuation if labor could not produce cash. We would be outraged if the small print in a Mutual of Omaha policy denied payments to Mr. Kerner. Because the United States, in its Social Security program, has tried to be Mutual of Omaha, judicial interpretation of the statutory ambiguity should mirror adjudication of a claim against a private insurer.[74]

Feelings of security, of status, and of assurance are important ingredients of human welfare. At the core of Social Security is a promise by the polity that a degree of labor force achievement justifies an expectation of income security against medical disability. In the 1967 amendments, Congress casually disregarded Mr. Kerner's reasonable expectations as a wage-earner, had he contemplated the possibility of disabling illness, and his expectations as a sick person when he sought the benefits toward which he thought he had contributed. It may be that the denial of benefits for partial disability illustrates a situation where the burdens of administration constrain the achievement of a social welfare system whose coverage is fully appropriate to its logic. *But if the program remains focused on total disability, then it should cover all cases in which a medical cause leads to total unemployment*, even if the claimant might be put to work by an ideal labor market. Social Security seeks to gain for the nation the increase in welfare incident to a broad expectation of protection. To keep that faith, it must meet the expectations thus engendered.

II. SSI DISABILITY

Millions of people medically unfit for labor are not eligible for Social Security disability: persons born with a disability, disabled during childhood, or dis-

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[73] The battle over *Kerner* continues. The 1975 Social Security Advisory Council adopted former HEW Secretary Cohen's suggestion that persons over 55 be eligible for disability benefits when unable to engage in their "customary occupation," *see* note 51 *supra*, instead of the present requirement of inability to engage in any substantial occupation. *See* Advisory Council Report, *supra* note 22, at 38–40. The Council's recommendation was that persons in the job gap receive 80 percent of the benefits paid to those who now qualify as disabled. This increase in coverage would cost the nation 0.13 percent of the total payroll subject to the Social Security tax. The durability of the judicial preference for the *Kerner* result is suggested by district court cases in which a close look at "substantial evidence" review suggests that the judge is attempting to exhume *Kerner* even after its clear legislative burial. *See, e.g.*, Thomas v. Richardson, 371 F. Supp. 362, 363–64 (S.D.N.Y. 1974); Lashbaugh v. Gardner, 294 F. Supp. 1143, 1145–46 (D. Ore. 1968). *But see, e.g.*, Brown v. Finch, 429 F.2d 80, 82–83 (5th Cir. 1970).

[74] For a case under a private insurance policy, but otherwise indistinguishable from *Kerner*, see *Snelson* v. *Pennsylvania Life Ins. Co.*, 65 Ill. App. 2d 416, 212 N.E. 2d 873 (1965). Snelson had worked as a bricklayer until he was injured. After the injury, doctors said there was a fair amount he could do, but he testified that when he went to the "unemployment place," he was told they "had guys in better shape . . . and not to come back." The policy insured against "total disability and total loss of time." The court held for the claimant, saying that "when a man is no longer able to do his accustomed task and such work as he has only been trained to do, and upon which he must depend for a living, he is totally disabled within the meaning of the policy in question." *Id.* at 429, 212 NE. 2d at 880. *See* also *Dixon* v. *Pacific Mut. Life Ins. Co.*, 268 F. 2d 812, 815–16, (2d Cir. 1959), cert. deneid, 361 U.S. 948 (1960) (permitting a surgeon to recover on his private disability insurance policy when he suffered an injury to his hand that would have permitted him to continue work only as a general practitioner).

abled as adults before achieveing sufficient experience at covered employment. From 1950 to 1972, the states provided income support to disabled persons unable to qualify for Social Security under one of the federally subsidized "categorical" aid programs,[75] which also included aid to the aged, the blind, and single parents.[76] In 1972, after considering the Administration's welfare reform proposals for two years, Congress concluded that despite universal rhetorical castigation of the present welfare system, there was no Senate majority for any particular alternative.[77] In the pain of that awareness, Congress retreated to a 194-page assortment that the newspapers treated as technical amendments to the Social Security Act.[78] Thus, little fanfare accompanied the most important federal income-support legislation since enactment of Social Security in 1935.[79] The amendments merged categorical aid for the aged, blind, and disabled, and created a new federal program called Supplemental Security Income (SSI).[80] Congress thus separated income maintenance for these three groups from Aid to Families with Dependent Children (AFDC).

In a short time, SSI became a major undertaking. Only a year after the program's inception, benefits were being paid to four million persons, and the President's 1976 budget projected expenditures of 5.5 billion dollars for SSI.[81] Qualification for SSI benefits by virtue of age or blindness is determined by objective standards of age or diminished sight.[82] Eligibility by reason of disability cannot be so easily determined, however, and cases testing the ambiguous statutory language inevitably pose difficult questions about the extent to which the nation has committed itself to an assurance of minimum income.

A. The significance of SSI qualification

It is important to recognize at the outset that the new SSI definition of disability is of great significance to a large number of persons. *Before SSI*, qualification for Social Security disability meant relatively generous benefits, payments as a matter of right, and respectable status as a former taxpayer struck from the workforce by medical catastrophe. Extensive litigation demonstrated both that the statutory standard of disability was hard to apply and that attaining the special status of a Social Security recipient was important to many persons. At the same time, millions of persons were receiving disability benefits from state welfare departments under the categorical disability program. The states established disability definitions that were no less ambiguous than the federal requirements, [83] but there was virtually no litigation.[84] The reason, presumably, was that most persons not called "disabled" instead received AFDC or general relief assistance, and were indifferent about which "welfare" category was the source of their support.[85]

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[75] See Social Security Act Amendments of 1950, ch. 809, § 351, 64 Stat. 555.

[76] See 42 U.S.C. §§ 301–06 (1970) (aged); *id.* §§ 601–10 (dependent children); *id.* §§ 1201–06 (blind).

[77] See 118 Cong. Rec., 16,801–69 (Oct. 4, 1972); *id.* at 16.921–17,032 (Oct. 5, 1972); *id.* at 18,495–500 (Oct. 17, 1972). For descriptions of the proposed reform plan, see H.R. Rep. No. 92–231, 92d Cong., 1st sess. (1971); S. Rep. No. 92–1230, 92d Cong., 2d sess. (1972); Conf. Rep. No. 92–1605, 92d Cong., 2d sess. (1972).

[78] Social Security Amendments of 1972, Pub. L. No. 92–603, 86 Stat. 1329; see, e.g., New York Times, Oct. 18, 1972, at 48, col. I.

[79] The only other substantial additions to the federal income-support effort were Social Security disability, see pp. 839–40 *supra,* and "categorical" disability aid. see p. 855 *supra*. Of course poor persons receive immense financial benefit from Medicaid, and Food Stamps, but these programs support only certain sorts of expenditures.

[80] Social Security Amendments of 1972, Public Law No. 92–603, §§ 1601–02, 86 Stat. 301–02 (Codified at 42 U.S.C. §§ 1381–82 (Supp. 111, 1973)).

[81] 38 Soc. Sec. Bull. 43 (October 1975); The Budget for the United States Government: Fiscal Year 1976, at 244 (1975).

[82] The age qualification is 65, 42 U.S.C.. § 1392c(a)(1)(A) (Supp. III. 1973), and "blindness" is defined as "central visual acuity of 20/200 or less in the better eye with the use of a correcting lens," *id.* § 1382c(a)(2).

[83] See, e.g., 23 Ill. Rev. Stat. § 3–1 (1968) ("physical or mental impairment, disease, or loss which is of a permanent nature and which substantially impairs . . . ability to perform labor or to engage in useful occupation for which he is qualified").

[84] One of the few pre-SSI state disability cases was *Zunino* v. *Carleson,* 33 Cal. App. 3d 36, 108 Cal. Rptr. 769 (Ct. App. 1973).

[85] Benefits were, however, usually higher under categorical disability assistance than under AFDC. See G. Steiner, Social Insecurity 24 (1966). In 1971, average benefit levels for ABPTD recipients ranged from a low of $50 per month in Alabama to a high of $177 per month in Alaska, with a national average of $98 per month. At the same time, average monthly AFDC payments ranged from $12 in Mississippi to $78 in New York, with an average of $50. See Department of Health, Education and Welfare, Social Security Programs in the U.S. 102–03 (1971).

SSI changed that. Whether one is "disabled" or "on welfare," previously only a technical distinction between categorical aid programs, is now a matter of the greatest practical, moral, and emotional significance. This is because our social welfare programs fall along a continuum that may be crudely described as running from legitimacy to stigma, from entitlement to gratuity. Before 1972, disabled persons ineligible for Social Security benefits were located with AFDC recipients at the least dignified position on the continuum.[86] Now, with SSI they have been moved toward entitlement, but their progression has stopped short of the place occupied by Social Security recipients.

Unlike AFDC or general relief arrangements, SSI is administered by the federal Social Security Administration,[87] and cash benefits are not conditioned on a work search or acceptance of "improvement" services. Indeed, the government has undertaken to seek qualified recipients;[88] and the statute and its implementing regulations emphasize entitlement rather than stigma.[89] Although financing of SSI through general revenues[90] and the program's means test[91] destroy any pretense that an individual has contributed toward his own protection, a recipient is much better off than those who must rely on AFDC or general relief. SSI benefits are not only administered differently; they have

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[86] On the differences between the Social Security disability and pre-1972 categorical disability, see tenBrock & Matson, *The Disabled and the Law of Welfare*, in The Law of the Poor 485, 494–9 (tenBrock ed 1966). Concerning the treatment of AFDC recipients and, by analogy, categorical disability beneficiaries, see, e.g., Joint Economic Committee, Issue in Welfare Administration: Welfare—an Administrative Nightmare 26–34 (1972).

The crucial distinction between Social Security and "welfare" is appreciated by legislators and administrators:

"Senator CHURCH. Could I just underline that point by saying that in my own experience I have always noticed how differently people regard Social Security and welfare. I think I have yet to find a person who thought that his Social Security benefits were related in an way to a welfare payment. They are thought of as matters of entitlement, and since everyone does share in them, since they extend to all persons considered by the program, regardless of income, there is no feeling that there is welfare in that program. It makes a great deal of difference to so many people.

"Mr. COHEN. That is why I say, Senator, one must view with very great concern the recommendations by many economists to change the financing because they look at the whole mechanism as a redistribution of income. I share their view. I am strongly for appropriate redistribution of their income through our tax system. But I want to be very careful that we don't try to inject into the Social Security system a redistribution philosophy that will ruin the public opinion support that you have just expressed which the American people have, and transform their concept of Social Security from a right into a welfare system. That would be a terrible loss.

Senator CHURCH. I agree with you completely."

Hearings Before the Senate Special Committee on Aging, 93d Cong., 1st sess., pt. 4, at 246 (1973). Welfare recipients' attitudes mirror the publicly perceived distinction. See Briar, *Welfare From Below: Recipients' Views of the Public Welfare System*, 54 Calif. L. Rev. 370, 377 (1966) ("Asked whether the social worker has a right to know how the aid money is spent, sixty-six percent [of AFDC recipients] said yes. . . . And asked whether in their opinion aid *should* be cut off [if not being spent properly], seventy-six percent of the recipients said yes."). An early and trenchant analysis of these issues were tenBrock & Wilson, *Public Assistance and Social Insurance—A Normative Evaluation*, I U.C.L.A. L. Rev. 237 (1954). Interestingly, SSI has almost exactly the characteristics recommended by Briar and others for a cash-transfer program that encourages recipients to feel like "rights-bearing citizens." See Briar, *supra*, at 383–85; Cahn & Cahn, *The War on Poverty: A Civilian Perspective*, 73 Yale L.J. 1317, 1329–31 (1964).

[87] See 42 U.S.C. § 1381a (Supp. III, 1973); H.R. Rep. No. 92–231, 92d Cong., 2d sess. 25 (1971).

[88] See New York Times, Oct. 30, 1973, at 22, col. 4; 119 Cong. Rec. S23,806 (daily ed. Dec. 21, 1973) (remarks of Sen. Dole commending Kansas' "outreach" program); New York Times, Nov. 20, 1973, at 43, col. 2 (similar outreach program in New York State). The presence or absence of a public policy of seeking out eligible persons and notifying them of the availability of an income-support program may now be the single characteristic most typical of programs closer to right than to gratuity. See generally Note, *Welfare Law—1972 Social Security Act Amendments—Supplemental Security Income for the Aged, Blind and Disabled*, 58 Cornell L. Rev. 803 (1973). Both the food stamp, see *Bennett* v. *Butz*, 386 F. Supp. 1059 (D. Minn. 1974), and medicaid programs, see *Woodruff* v. *Lavine*, 399 F. Supp. 1008 (S.D.N.Y. 1975), require such "outreach" efforts. No similar effort could be imagined in AFDC. In England seventy-five years ago, however, the difference between an "of right" and a "gratuitous" benefit program was whether recipients were disenfranchised. See A. V. Dicey, Lectures on the Relation Between Law and Public Opinion in England During the Nineteenth Century XXXIV–XXXV (2d ed. 1914).

[89] See 42 U.S.C. §§ 1381–85 Supp. III, 1973); 39 Fed. Reg. 28,626 (1974) ("conditions that are as protective of people's dignity as possible," § 416.110(c)).

[90] 42 U.S.C. § 1381 (Supp. III, 1973).

[91] *Id.* § 1382.

been rising with the cost of living in a period when AFDC benefits have remained constant or have been reduced.[92]

SSI recipients are thus encouraged to feel that their nonemployment is excused, that they suffer from a sad accident of fate, and that society accepts responsibility for their support. On the other hand, everyone else who needs income support must almost by definition be a person whose poverty is his own fault. This group may be denied public income support altogether.[93] Even when persons receive AFDC or general relief benefits, the checks are normally smaller than SSI payments and are often accompanied by moralistic lectures or "work requirements" that assume a propensity for indolence.[94] Perhaps more important, an AFDC or general relief recipient is "on welfare," and cannot escape the message—from potential employers, from his children's teachers and friends, and from his own family—that he has failed and is supported only by the ultimate grudging charity of a stern society.[95]

Inherent in Congress' decision to separate the three SSI categories from AFDC must have been a notion that SSI recipients deserve better of society than those who can only qualify for AFDC.[96] The new SSI administrative arrangements translated that statutory assumption into more favorable benefits and less onerous procedural requirements for SSI recipients. But how did Congress define the subgroup of the needy who should receive this special treatment?

B. SSI: The qualification questions

In composing a statutory definition of SSI disability, Congress tracked the language that now describes Social Security disability qualification. An applicant must be "unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment" likely to result in death or extend for twelve months;[97] and medical inability to work is to be determined "regardless of whether a specific job vacancy exists for him or whether he would be hired if he applied for work."[98] But, as was argued above, the important fact about Social Security disability is its coverage of those who have won a place in the labor force and been struck from it by medical tragedy. Thus Congress' use of the Social Security disability definition in the SSI law was psittacistic. SSI can take Social Security's words but not its meaning, because the SSI test will generally be applied to persons who have never worked.[99]

The distinction between the two programs can be illuminated by considering the eligibility of a person in the job gap. Such an applicant will be someone whose medical impairment prevents attainment of his full potential as a worker, who can nonetheless do some work, but who finds none. With respect to Social Security disability, it was argued above that the clarifying question ought to be whether all workers should be able to feel secure against income loss

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[92] Even before SSI took effect, benefits were increased, Public Law 93–368, 88 Stat. 422 (1973). SSI benefits now automatically increase to cover inflation. See 42 U.S.C.A. § 1382f (1974).

There are several quirks in the SSI/AFDC equation. Using national standards, SSI pays at levels that seem high in Mississippi but low in California. The federal government holds a state "harmless" for case-load growth only to the extent that it supplements federal payment schedules to the levels at which the state was paying in December 1973. Thus, especially with recent high inflation, AFDC benefits in a few states are now higher than SSI levels. There are also differences in the methods of computing benefits that can make large differences to many participants. AFDC in New York pays rent plus the established support level; SSI is straight cash. With rents so high, AFDC can be a better deal. These issues are discussed in New York State Assembly Standing Committee on Social Service, Hearing Report: Problems in the Supplemental Security Income Program (1974).

[93] See A. LaFrance, M. Schroeder, R. Bennett & W. Boyd, Law of the Poor §§ 305,309 (1973).

[94] See, e.g., *New York State Department of Social Services* v. *Dublino,* 413 U.S. 405 (1973); Calif. Welfare and Institutions Code §§ 11300, 13650 (1972). See generally Comment, *The Failure of the Work Incentive (WIN) Program,* 119 U. Pa. L. Rev. 485 (1971).

[95] See note 86 *supra.*

[96] "[Y]our committee believes that the American people do not want a system which results in promoting welfare as a way of life. [Therefore, we have attempted to provide] adequate assistance to those who cannot help themselves, while . . . maximiz[ing] the incentive and the obligation of those who are able to work to help themselves." H.R. Rep. No. 92–231, 92d Cong., 2d sess. 2 (1971).

[97] 42 U.S.C. § 1382c(3)(A) (Supp. III, 1973).

[98] *Id.* § 1382c(3)(B).

[99] A hint that the plagiarized definition is a result of bureaucratic routine rather than legislative choice is its use again when Congress almost enacted an income tax exemption for the disabled in 1971. See H.R. Rep. No. 92–708, 92d Cong., 2d sess. 49 (1971).

occasioned by medical disability in an unfavorable labor market. Under this test, and under *Kerner*, the job gap applicant would receive Social Security disability benefits if he has a record of sufficient prior work at covered employment. Under SSI, however, the touchstone of expectation that requires Social Security disability coverage is not available, because SSI applicants will generally have failed to establish a place in the workforce.[100]

As the SSI statute is currently written, ineligibility of job gap claimants is clear. Congress' incorporation into SSI of the post-*Kerner* Social Security disability definition denies benefits to such persons. In deciding whether SSI exclusion is appropriate, it is useful to note the differences between the SSI welfare estate and that just below—the work-search and employment lecture requirements. The absence of these requirements in SSI indicates that SSI recipients ought to be persons for whom such requirements are otiose. Thus, if an individual can work, SSI tells him that he should be making the same efforts as one with no medical explanation for his decline but similar skills and prospects. On the other hand, the SSI program does seem to accord special social legitimacy to the persons it benefits, and medical infirmity is the key to this favored status. But since ability to work, and thus to "profit" from work-search requirements, also seems to be a consideration in SSI's exclusion of the partially disabled. it is perhaps defensible to conclude that a person thrust into the job gap by a medical occurrence who can still work should be ineligible for SSI disability.

A number of other outcomes required by the current SSI statute are not so easily comprehended. Consider the following cases:

(1) the person who suffers a terrible automobile accident at age 16, will be in bed for years, and will be unable to earn the minimum wage;

(2) the person born with very low levels of intelligence and physical coordination, who will be at the end of every job queue, and will work only if the economy achieves something approaching full employment;

(3) the mother of two children under four, whose husband a student, dies of a heart attack; she could work, but her wages will not defray the cost of child care,[101] and no subsidized daycare facility is available;

(4) the heroin addict who has on four separate occasions entered a methadone program, become stabilized, started work, suffered emotional turmoil, quit the job, and then resumed heroin abuse.

This SSI statute provides disability benefits only in Case (1). Case (2) may approach mental retardation, and if the doctors are willing to describe the individual as mentally impaired, the hearing officers will award disability benefits. But, as the individual is described here, he is not sick but is "only" someone who will almost never be employed in our economy. Therefore he may be eligible for AFDC or general relief, but he cannot qualify for SSI.

The mother in Case (3) is in no way physically afflicted. Her need is not caused by a permanently high-unemployment economy. She is a single parent, in a society that incongruously emphasizes the importance of both work and child care while providing insufficient publicly subsidized facilities for the children of working parents.[102] Although she is the paradigm case for AFDC benefits, when she seeks those benefits she will be entangled in what will seem to her a bureaucratic nightmare: work requirements but few jobs, and no suggestions for care of the children.

Case (4) is more complicated. The American Psychiatric Association says heroin addiction is a disease,[103] but the SSI statute requires whole-hearted participation in a treatment program.[104] This individual is capable of that, but not steadily. When he is in treatment, he can work. But, before long, he is likely to resume drug abuse. Taking only SSI's general qualification clauses, this might be

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[100] There is an overlap between SSI and Social Security, however. Nearly half a million Social Security disability beneficiaries receive so little that they also qualify for SSI. See *Mathews* v. *Eldridge*, 44 U.S.L.W. 4224, 4231 n. 27 (U.S. Feb. 24, 1976). These persons are permitted to disregard only the first twenty dollars per month of Social Security benefits in calculating their SSI "need." See 42 U.S.C. § 1382a(b)(2) (Supp. III, 1973).

[101] See C. Schultze, E. Fried, A. Rivlin & N. Teeters, Setting National Priorities: The 1973 Budget 256–85 (Brookings Inst. 1972).

[102] Cf. *Loveless* v. *Weinberger*, 492 F. 2d 1291, 1293 (6th Cir. 1974) (denying Social Security coverage for a quarter in which claimant took care of her grandchildren, and rejecting the argument that "the first and most important 'trade of business of plaintiff's daughter . . . was to care for her minor children").

[103] See Committee on Nomenclature and Statistics of the American Psychiatric Association, Diagnostic and Statistical Manual of Mental Disorders 92 (2d ed. 1968).

[104] 42 U.S.C. § 1382(e)(3) (Supp. III, 1973).

a difficult case. Is the addict "unable" to work or only unwilling? Is this shortcoming a "medically determinable . . . impairment" or only a severe emotional maladjustment? Is the inability sufficiently permanent? Congress has, however, specifically required treatment of those addicted to alcohol and drugs as a condition of SSI eligibility. If comprehensible at all, these requirements must represent a legislative judgment that there cannot be an "inability" to participate in treatment, or at least that no such inability can be a sufficiently "medical" failing.

Thus the distinctions required to select the persons who are disabled from those who are merely in need must reflect two different sorts of public judgments. First, they show a policy of imposing work rules on needy persons who are healthy enough to work. The restrictions may be difficult or impossible to administer successfully. They may be a poor substitute for incentive arrangements by which work would pay better than non-work. But, if we are unwilling to raise low wages substantially, and also unwilling to reduce AFDC and general relief benefit levels, many welfare recipients will have no financial incentive to obtain jobs. We respond to that problem by giving benefits only on a showing of work-search, and by denying them on certain showings of unjustified refusal of or departure from work.

If this were the only purpose of the administrative requirements attached to the remaining non-federalized assistance programs, SSI disability would have a clear focus. It would be the category of those who ought not be subjected to work-search: because we will pay them whether they look or not; we are positive they will not find anything; or, on balance, we would just as soon not have them working.[105] So defined, SSI would include all the cases described above. In cases (1), (2), and (4) work incentives are more trouble than they are worth for both the administrators and the recipient. The mother in case (3) ought not be required to seek work because she can do more social good at home than in a low-wage job. But SSI does not go this far, because it applies only to persons with a "medically determinable" inability to work. A policy of encouraging work cannot explain this restriction, because SSI denies benefits to many persons whom any sensible inquiry would classify as extremely unlikely to achieve a place in the workforce.

The boundaries of SSI must therefore reflect a second factor, a moral judgment. In this view, the program describes not only persons who cannot work, but persons whom we are willing to anoint as legitimately unable to work. The requirement of "medical" disability functions to demarcate those whose poverty is sympathetic from those who are poor without excuse. We say of those medically unable to work that their circumstance deserves more sympathy, and more money, than the

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[105] The matter is not quite this simple. The Social Security program has never sought to discourage eligible persons from obtaining benefits, and indeed has had a positive goal of enticing persons beyond retirement age from the labor force. See 42 U.S.C. § 403 (1970). SSI is, among other things, a "welfare" program, and therefore a category which everyone should seek to avoid. To help persons escape SSI, the program "taxes" attempts to achieve economic independence quite mildly. *See id.* § 1382a(b)(4) (Supp. III, 1973). Thus a person must be entirely unable to work in order to qualify for SSI disability benefits, but can then become able to do some work and still retain some of his SSI benefits as he achieves a low income. These provisions expose apparently conflicting public goals: the requirement of absolute dependency as a condition of qualification, yet the rejection of arrangements, *e.g.*, a 100 percent tax, that might discourage work efforts. But the goals are not necessarily in conflict. Consider, for example, he cases of physically handicapped persons who can work productively with training, emotional support, and workplace adjustments. Or consider persons with past or present alcohol and drug problems, who can move gradually toward capacity and dignity if supported in the right way. For many such persons, a cost-benefit analysis will not justify the amount of remedial service needed to permit labor-force paticipation. The government would gain financially if it declared these persons disabled and supported them, rather than taking the steps necessary to permit them to work. Yet other values—inquity, equity, justice—argue for rehabilitation expenditures, which should be seen as a public obligation to the disabled individuals rather than as prudent conservation of the fisc. *See generally* Farber, *The Handicapped Plead for Entrance the Will Anyone Answer?* 64 Ky. L.J. 99 (1975). It may be that a stated separation between the disabled and the unemployment, the two groups divided by society's conclusion about whether they need work, would hinder some rehabilitative efforts that are assisted by the fuzzy overlaps among existing programs. But, at least in history, it is possible for society's attitude toward the disabled to be: "You need not work; minimal support is available: but if you desire rehabilitation, it too is available; and it will seek to bring you to the highest possible level of capacity." Such a policy could, for example, justify public expenditures for child care services that permit mothers to work, even where their earnings are less than the cost of child care. *See* note 101 *supra*.

circumstance of others whose economic situation is as desperate but whose reason is different. Thus this law creates not only economic outcomes, and not only bureaucratic arrangements for carrying out its economic policies, but also a further refinement of the system of socially and morally explicit categories into which welfare laws distribute the citizenry.

C. SSI as an attempt to confer status

Stating that SSI disability assigns a status does not explain why the line has been drawn where it has. Deterrence alone is not a sufficient explanation. The persons represented by cases (1), (2), (3), and (4) appear equally unable to affect their present circumstances, and yet only case (1) qualifies for SSI. Perhaps we fear that the availability of unstigmatized benefits will encourage undesirable conduct in the future. "Medical" may thus be shorthand for events entirely outside the influence of an individual, and thus entirely unaffected by the possible incentive effect of relatively generous income support. As a factual matter, however, such an assumption seems dubious. Cases (2), (3), and (4) seem consequences of general social and cultural phenomena more than of individual planning. Our society may revere medicine and sympathize with the sick, but it holds no views that could explain distinctions between persons totally unable to work according to whether their condition results from an illness or, on the other hand, from limited natural abilities, decades of racism or sexism, homosexuality, family burdens, technological change, a broken home, or national fiscal policy.

A better explanation is that the categories SSI creates are assigned classifications of social standing, a modern version of the traditional estates real that classified individuals according to their relationship to the land.[106] SSI thus implements fundamental choices by Congress about the nature of the relationship that a large group of citizens should have to each other and to the state. Congress could have brought old, blind, and disabled low-income persons within Social Security. It rejected this alternative presumably because it would have destroyed a distinction believed important—that between insurance and welfare. A second alternative was also rejected. Benefits for those of the poor who are old, blind, or disabled could have been increased without altering the structure of the former categorical programs. But Congress was plainly ready to make a social value judgment about these persons, to declare their poverty to be a matter largely beyond their individual control, and to accept national responsibility for their support.[107] A preference was expressed, legislatively and then administratively, for the social benefits of unstigmatized, reliable income support for this group of recipients.[108]

When the society assigns a status such as SSI eligibility, it tells a person how he should regard himself and how he should conduct some of his relationships

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[106] See Reich, *The New Property*, 73 Yale L.J. 733 (1964); Reich, *Individual Rights and Social Welfare: The Emerging Legal Issues*, 74 Yale L.J. 1245 (1965). See also E. Goffman, Stigma 137 (paperback ed. 1969):

"Although these proposed philosophies of life, these recipes of being, are presented as though from the stigmatized individual's personal point of view, on analysis it is apparent that something else informs them. This something else is groups, in the broad sense of like-situated individuals, and this is only to be expected, since what an individual is, or could be, derives from the place of his kind in the social structure.

"One of these groups is the aggregate formed by the individual's fellow-sufferers . . . ."

[107] For a prescient argument that the distinction between employable and unemployable welfare recipients, while crude, is useful because the taxpaying public has more difficulty accepting welfare programs that benefit employable persons, see Handler & Hollingsworth, *Work, Welfare, and the Nixon Reform Proposals*, 22 Stan. L. Rev. 907 (1970).

[108] Obviously it would be wrong to assume that a "disabled" stamp can be placed on a person without stigmatizing him. See Maclean & Jefferys, *Disability and Deprivation*, in Poverty, Inequality and Class Structure 165, 172 (D. Wedderburn ed. 1974). The real questions are the conduct to be approved and encouraged by particular social categories, the groups thereby to be formed for political contest, and the attitudes categorized persons are to be permitted to take to themselves. In Goffman's language:

"It should be plain that . . . advocated codes of conduct provide the stigmatized individual not merely with a platform and a politics, and not merely with instruction as to how to treat others, but with recipes for an appropriate attitude regarding the self. To fail to adhere to the code is to be a self-deluded, misguided person; to succeed is to be both real and worthy. . . ."

E. Goffman, *supra* note 106, at 135. Accepting difficulties in applying concepts such as these to real-world facts, it seems fair to conclude that SSI is a step forward for persons covered, but that its existence may make life more difficult for persons remaining under AFDC.

with others.[109] Thus when the SSI groups were separated from AFDC recipients, but not given quite the same treatment as Social Security participants, SSI recipients were told that they too had a group to look down upon, but that they still had to look up at those who have worked. As the statute classifies the population into sub-groups officially determined to be appropriate, it gives SSI recipients a regular income and a shred of legitimacy at the expense of the reclassification of those below them, who have once again failed to achieve recognition.

SSI can therefore be seen as an attempt to transfer, in its definition of disability, nonmonetary benefits to recipient through the knowledge that a substantial group has been judged less worthy. Indeed, an important determinant of Social Security policy has been a widely held belief that recipients' feelings of entitlement and legitimacy depend on exclusion of the undeserving.

But if welfare categories are drawn in a way that divides the population according to rankings of moral legitimacy, the bounds of the categories must be tested against a larger scheme of shared values, a test the new SSI definition cannot pass. The significance of SSI is that it exempts its recipients from work-search requirements and legitimates dependency with its implicit declaration that recipients are out of work for approved reasons. Yet, as we have seen, all four of the example cases, as well as the medically disabled, are persons we ought to spare from work requirements. All four should therefore receive minimal income support without proving their willingness to work and should be designated as excusably removed from the working population.

If we are to take seriously Congress' creation of an intermediate social welfare estate in SSI, one between the state-created expectations of Social Security recipients and the plight of the undeserving poor, then the current limitation of SSI benefits to those who are totally disabled by medical cause should be abandoned. Congress should be regarded as having said that our society has one form of insurance that attaches to wage-earners when they work and pay Social Security taxes, and that we now have another form, SSI, that is applicable at birth to all citizens. The SSI estate is financed by general taxes and should protect those people who—it is generally felt—ought to receive benefits because they have been victims of occurrences that might strike any person, and because we are prepared to say that these persons need not work. Even if the economy were running well, and jobs were available for all who wanted them, we would not expect these persons to work; or at least we would be willing to support them whether or not they sought work.[110] The logic of SSI thus requires that the income support commitments undertaken in that program be extended to all those whom we do not expect to work but who are excluded by SSI's arbitrary "medical" qualification.

Senator NELSON. Our next witness is Mr. Paul Jackson, FSA, actuary of the Wyeth Corp., speaking on behalf of the Small Business Legislative Council.

Mr. Jackson, would you identify your associate for the reporter?

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[169] *See* E. Goffman, *supra* note 106, at 168:

"The member who is defined as physically sick is in somewhat the same situation [as the member of a group who is authorized to be deviant because he is regarded as eminent]; if he properly handles his sick status he can deviate from performance standards without this being taken as a reflection on him or on his relation to the group. The eminent and the sick can be free, then, to be deviators precisely because their deviation can be fully discounted, leading to no re-identification; their special situation demonstrates they are anything but deviants—in the common understanding of that term.

[110] The distinction is at least 300 years old. For example, the Old Poor Law, Eliz., c. 2 (1601), distinguished between "(1) the children of parents unable to keep and maintain them; (2) such persons who, having no means to maintain themselves, used no ordinary and daily trade of life to get their living by; (3) the lame, impotent, old, blind and such others as were poor and not able to work. The first two of these classes were to be relieved by being set to work. The third class were to be relieved without work." *Attorney-General* v. *Guardians* of the ——— of the Merthyr Tydfil Union, [1900], I Ch. 516, 541.

STATEMENT OF PAUL H. JACKSON, CONSULTING ACTUARY, WYATT CO. ON BEHALF OF THE SMALL BUSINESS LEGISLATIVE COUNCIL, ACCOMPANIED BY HERBERT LIEBENSON, VICE PRESIDENT FOR GOVERNMENTAL AFFAIRS, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. JACKSON. My name is Paul Jackson. I am a consulting actuary with the Wyatt Co. I am testifying today on behalf of the Small Business Legislative Council, which is an organization of national trade and professional associations predominantly made up of small businesses.

Accompanying me this morning is Herbert Liebenson, vice president for governmental affairs of the National Small Business Association.

The Small Business Legislative Council sincerely appreciates the opportunity to present the views of small business on a topic as important and fundamental as our social security program and its financing.

Our 107 organizations, representing approximately 375,000 small businesses, support in principle the Council position, as follows:

The proposals to put the social security system on a sound fiscal basis are, for the most part, desirable, but the administration's plan to accomplish the objectives is unwise. If employees are not willing to share the costs of the present program equally with their employers, then the social security program has already gone beyond the point of self-support, and benefit increases built in for the future should be reduced. Employers should not be taxed on pay that the employee is not taxed on just because that is a convenient way to get money. The program should continue to be financed 50–50 employee and employer alike.

SBLC recommends that the "decoupling," self-employed tax and dependency test proposals be adopted now and that the rest of the changes be referred to the next Social Security Advisory Council for thorough and careful review.

Small employers and their employees contribute equally to the U.S. social security system. Social security is the basic program through which the workers in the smaller companies achieve financial security and independence in their old age. Indeed, in many instances, it is the only program, apart from individual savings, since many small businesses have not found it financially possible to provide a private retirement plan.

In recent years, in fact, many small businesses have been forced to drop their private retirement programs because of the recordkeeping and financial burdens imposed by ERISA. Many more small businesses will be discouraged from starting such programs. In this framework, clearly, the social security program and the benefits it provides are of prime importance to small business and to its workers.

Throughout its history, social security has been financed almost entirely by taxes collected from workers, by matching taxes collected from their employers, and by the interest earned on the invested balance of the trust funds. For example, in the most recent fiscal year, over 99 percent of the total income to the trust funds came from social security taxes and interest earnings, and only three-quarters of 1 percent came from special reimbursements from the General Funds of the Treasury for certain costs that are not financed by payroll taxes.

We believe this system of sharing the cost equally has worked well in the past and should be continued in the future because the financial support for the system is then drawn from the parties who expect to enjoy the benefits from the system; namely, the employees and their employers.

Small businessmen have learned over the years the value of restraint in financial matters. Giant enterprises and governments may have unlimited lines of credit available to them, but the small businessman knows that when his cash runs out, his credit is likely to run out also.

Small businessmen have found through practical experience that some hard choices must be made in deciding their own employee benefits because it is a rare small business indeed that is able to support the entire range of benefits that would be typically offered by the larger or older enterprises.

We believe this sense of restraint is also necessary in connection with social security. It is obvious that all of us could think of larger or more extensive benefits for social security and all of them might be desirable, but the line must be drawn at the point where we become unwilling or unable to pay for them.

We believe that time has already come because the benefits promised in the 1972 Social Security Amendments are simply proving to be more than we can support financially, and the chief cause is the excessive adjustment for inflation which was included in social security in 1972. We believe, therefore, that perhaps the most important aspect of the current legislative proposals is the correction of the social security benefit formula to eliminate the double adjustment for inflation and to "decouple" the program, and we support this wholeheartedly.

In May 1977, President Carter sent to Congress a legislative package dealing with the social security problem. The principle proposals were:

One, institute countercyclical general-revenue financing to replace lost taxes when unemployment exceeds 6 percent;

Two, remove the ceiling on the amount of an employee's pay on which the employer pays social security taxes;

Three, increase the self-employed tax rate to the traditional level of 1½ times the tax on employees;

Four, shift some funds from the hospital insurance trust to the old age fund;

Five, add $600 to the wage base otherwise effective in each of 4 years, 1979, 1981, 1983, and 1985;

Six, change the dependency test in conformity with recent Supreme Court decisions requiring men and women to be treated equally;

Seven, modify the social security benefit formula to eliminate the inflation overadjustment now in the law—usually referred to as "decoupling";

Eight, advance to 1985 and 1990 the 1-percent increase in tax scheduled to go into effect in 2011.

Certain of the foregoing proposals are desirable and indeed necessary in order to preserve the financial soundness of the social security system. It is absolutely necessary to adopt a decoupling amendment. It is most desirable to restore the traditional 1½ time tax for self-employed workers. Because of recent Supreme Court decisions, it is also necessary to change the dependency test to conform with with current legal requirements. These changes clearly should be adopted and adopted promptly.

Small business opposes two of the proposals as being completely undesirable because they violate the fundamental principle on which the social security program is based. The proposal to eliminate the ceiling on an individual worker's wages on which the employer must pay tax would destroy the 50–50 cost sharing principle. The proposal to institute countercyclical general revenue financing is only needed if social security is underfinanced and imposes a financing burden on general revenues at precisely the wrong time.

We are unalterably opposed to these two changes.

The proposal to remove the ceiling on the amount of an employee's pay on which the employer must pay social security tax is unsound and unwise. When fully phased in by 1982, this proposal is supposed to develop an additional $11.4 billion of taxes out of the grand total of $13.1 billion of new revenue in that year from all of the President's proposals. In short, this one proposal accounts for 87 percent of the new financial support.

If employees are unwilling to pay an increased tax to support social security, why should any additional burden be put on their employer or even on some other employer; up to now, the 50–50 matching has allocated social security costs to the employees whose wage records are covered for benefit purposes and their employers. The costs have been allocated roughly in proportion to which the employees can anticipate benefits from the system.

On the other hand, this particular tax on earnings above the social security wage base would add no burden whatever to the small employer in an industry with low-paid employees and yet it could increase Social Security taxes by as much as 100 percent on small employers in high-technology industries.

If additional financing is required for the social security system, it is just not right to try and unload it on some of the employers while other employers and all employees get off scot-free. All employees earning up to the social security tax base are now promised benefits based on their pay up to that tax base; and if those benefits cost more than is now being paid into the system in taxes, the added cost should be borne by all of them and by all employers and not passed on only to the employers of higher paid people. If the benefits are for everyone, the cost should be shared by everyone.

We can understand the general attitude of some groups in looking at this added tax. There is always the hope that the burden can be

placed on somebody else's shoulders, and the idea of passing the Social Security cost on to the big corporations who pay their executives large amounts, looks like an easy solution.

Small business opposes this solution, however, because it would hurt the high-technology companies in aerospace and computer applications, in xerography and communications, and most of them are small businesses. It would impose a heavier social security tax burden on companies employing engineers and scientists, computer experts and chemists, mathematicians and research personnel.

In short, it would impose an unfair tax burden on the leading edge of the American industrial complex, and that is just the wrong place to discourage future activity.

Small businesses are usually started by a few owner-managers who risk their own capital and contribute their own efforts. In the early years of most small businesse, there is not enough in the way of earnings, or no profits at all, and the businesses cannot obtain sufficient credit so that the end result is that the owner-managers underpay themselves.

In a sense, this is their investment in the business. When the financial rewards do come, there are two ways the owner-managers can get them:

One, by way of dividends on their stock, and the Federal Government is already taxing that form of income twice; and

Two, in the form of higher salary, and now we have before us a proposed 6-percent whack on that in order to bail out the social security system.

This proposal clearly discriminates against small businesses and the people who start them up.

Not only does this proposal put the burden in the wrong place, it distorts the balance in the social security system in ways which may be unintended. Here are two illustrations of some unintended side effects.

First, from time to time. Congress has raised the social security wage base, and this not only raises the level upon which benefits are based but also increases the level of wages on which taxes will be collected from both employer and employee. If the ceiling on the amount of pay on which the employer's social security tax is levied were to be removed, then any future proposal to increase the wage base will bring with it the same benefit improvement as in the past, but only half of the added revenue since the employer's portion of the tax on the additional earnings will have already been anticipated by this 1977 proposal. In effect, we are counting as future income the employer's portion of the tax involved in future wage base amendments in advance of the amendments themselves. The employer's tax on wages over the social security tax base should be used as income to the system only if and when the tax base is raised. If we collect the taxes before that time, then it will be much more costly to raise the wage base if that should ever be desirable at some future date.

A second illustration of the distortion of the program is the impact on certain special groups such as public-school teachers. While public school systems employ many lower paid individuals, the salaries

paid to pubic-school teachers are set at a level appropriate for professionals and rise in proportion to service and additional education.

In the case of a typical New York State school district, more than half of the teachers having 5 years of service have scheduled pay in excess of the social security tax base. These public school systems have the choice of remaining in the social security system or leaving it. To impose added taxes on such school districts without any evident increase in benefit would merely encourage more such systems to withdraw from social security.

The problem is even worse because teachers' salaries are greatest in the school systems operated by the major cities and least in the rural areas. Therefore, the added burden would fall on systems like the New York public schools and certainly would make the alternative of dropping out of social security that much more attractive to them.

Position.—Small business is fundamentally opposed to the proposal to tax employers on total payrolls because it is not right. If the present social security system needs more money, it should get it from the employees who are covered by the system, and their employers will match the added tax dollar for dollar.

One of the proposals to fix up social security financing would draw on general revenues whenever unemployment exceeds 6 percent. As the proposal is drawn, it would appear to be limited to the years 1975–78, with the cash actually being transferred to the social security funds in the years 1978, 1979, and 1980. This proposal is obviously aimed at the short-term financial difficulties. It is hard to see how this could actually help the situation in the long run.

If the general revenue burden is included in years of high unemployment, it would merely increase the national debt and not the actual financing of social security since there will already be budget deficits in those years.

Even more to the point, however, by imposing added general revenue costs in bad business years, the demand on general revenue could not come at a worse time because it will reduce the government's ability to adopt financial solutions to alleviate unemployment or to help small businesses.

We believe it is very poor financial planning for the Government to undertake to support the social security program only in those years when there is likely to be a maximum demand on Government to support the unemployed directly or to assist small businesses that are failing or in dire financial straits. It obviously would be far smarter for us to set the level of social security financing at a point where, on the average, it will support the system over a long period of years consisting of both good years and bad years. This is true countercyclical financing because the system in good years could then build up trust fund balances that woud support the system when employment falls off.

Position.—Small business opposes the proposal to use general revenues countercyclically for social security financing. When times are bad, Government programs to help small businesses should be expanded and any requirement to support social security from general revenues in those same periods will just get in the way.

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The other proposals which have been made do not appear to be immediately necessary and they appear to be cosmetic rather than substantive.

The proposal to shift money from the hospital insurance trust fund to the retirement trust funds clearly leaves the social security trust funds in the same position they were in before the shifting. Apparently, the reason for this proposed shift is that it is hoped that current proposals to control hospital costs. Small business is skeptical about spending future savings before it is sure that the savings will actually be there.

The proposal to take the rate increase included in the present law for the year 2011 and advance it to the years 1985 and 1990 would help make things "seem right" in 1977. On the other hand, not 1 cent of additional income will be received by the trust funds until 1985. We seriously question whether it is wise to pay high benefits now if we are only willing to increase taxes 10 years in the future. It does not appear to be a sound approach.

The proposal to provide for several $600 increases in the wage base at 2-year intervals from 1979 through 1985 will increase both the tax receipts and the benefits paid by the system, but, of course, the effect on taxes will be earlier and this will help the short-term cash shortage.

For the long-term, if the taxes are set at a level where they support the benefits, there will not be too much financial help to social security in raising the tax base. It does not make much sense to take on bigger benefits permanently just because the earlier payment of the increased taxes will help out in a short-run financial squeeze.

Position.—We recommend that these proposals be referred to the next Social Security Advisory Council for their study and analysis.

Small businesses and their employees are counting on social security to work out right in the long run. We do not believe that Congress should take the easy way out by tinkering around with the financing of the social security system in an effort to make things seem right. Indeed, some of the proposals resemble the imaginative accounting solutions adopted by New York City to make their books look better.

What is needed is more of a cash on the barrel-head approach that sets the benefits at a level which the tax-paying employees are willing to support. The small businesses who employ them have accepted the obligation to match those taxes dollar for dollar. Small businesses and most private families, too, all have learned the hard way that our ability to pay is a good deal less than our ability to think up things which we have to have.

We support wholeheartedly a change in the social security system today that would decouple benefits and leave them at a level which can be supported in the long run. There have been a number of specific proposals as to just how this is to be done, but we suggest that the process should go further. Specifically, the wage records of the individuals covered by the social security system should be adjusted in such a manner that when they retire their benefits will not have been lost through inflation. In addition, we recommend that this adjustment should be such that the generous benefits for em-

ployees with low earnings will in fact be limited to full-time employees with low average pay or lower-paid employees with long periods of sporadic earnings that are consistently low.

Part of the financial deficit in the social security system is due to employees of the Federal Government who are covered by a general Civil Service Retirement System but who, after their retirement, work a few years in social security employment—or who moonlight for a few years during their Federal careers. These "double-dippers" now end up with low average earnings and thus make off with the generous benefits that were intended for the regular low-paid worker. Small businesses, many of whom cannot afford their own private pension plans, should not be expected to pay taxes to support these added, and undeserved, social security benefits on top of the Civil Service Retirement System. This loophole should be corrected now.

Senator NELSON. That is the second bell on a rollcall, so I will have to go over and vote now. I will be back in about 10 or 12 minutes.

Mr. JACKSON. We can finish now.

Senator NELSON. The balance will appear in the record. We appreciate your comments.

[The prepared statement of Mr. Jackson follows. Oral testimony continues on p. 332.]

STATEMENT OF PAUL H. JACKSON ON BEHALF OF THE SMALL BUSINESS LEGISLATIVE COUNCIL

Mr. Chairman, my name is Paul H. Jackson. I am a Consulting Actuary with The Wyatt Company. I am testifying today on behalf of the Small Business Legislative Council (SBLC)—an organization of national trade and professional associations whose members are predominantly smaller businesses. The basic purpose of SBLC is to maximize the influence and strength of small business on issues of importance to the entire small business community . . . issues or areas in which the Council member associations are in substantial agreement. Accompanying me is Herbert Liebenson, Vice President for Governmental Affairs of the National Small Business Association.

The small Business Legislative Council sincerely appreciates the opportunity to present the views of small business on a topic as important and fundamental as our Social Security program and its financing.

107 organizations support in principle the Small Business Legislative Council position that:

> "The proposals to put the Social Security system on a sound fiscal basis are, for the most part, desirable but the administration's plan to accomplish the objectives is unwise. If employees are not willing to share the costs of the present program equally with their employers, the the Social Security program has already gone beyond the point of self-support and benefit increases built-in for the future should be reduced. Employers should not be taxed on pay that the employee is not taxed on just because that is a convenient way to get money. The program should continue to be financed 50–50 by employee and employer alike.
>
> SBLC recommends that the "decoupling", self-employed tax and dependency test proposals be adopted now and that the rest of the changes be referred to the next Social Security Advisory Council for thorough and careful review."

These prestigious organizations speak for over 372,000 small business firms in their industries. A list of these organizations appears at the end of this statement.

Small employers and their employees contribute equally to the United States Social Security System. Social Security is the basic program through which the workers in the smaller companies achieve financial security and independence in their old age. Indeed, in many instances it is the only program, apart from individual savings, since many small businesses have found it financially possible to provide a private retirement plan. In recent years, in fact, many

small businesses have been forced to drop their private retirement programs because of the recordkeeping and financial burdens imposed by ERISA. Many more small businesses will be discouraged from starting such programs. In this framework, clearly, the Social Security program and the benefits it provides are of prime importance to small business and to its workers.

Throughout its history, Social Security has been financed almost entirely by taxes collected from workers, by matching taxes collected from their employers and by the interest earned on the invested balance of the trust funds. For example, in the most recent fiscal year, over 99 percent of the total income to the trust funds came from Social Security taxes and interest earnings and only three-quarters of one percent came from special reimbursements from the general funds of the Treasury for certain costs that are not financed by payroll taxes. We believe this system of sharing the cost equally has worked well in the past and should be continued in the future because the financial support for the system is then drawn from the parties who expect to enjoy the benefits from the system; namely, the employees and their employers.

Small businessmen have learned over the years the value of restraint in financial matters. Giant enterprises and governments may have unlimited lines of credit available to them but the small businessman knows that when his cash runs out, his credit is likely to run out also. Small businessmen have found through practical experience that some hard choices must be made in deciding on their own employee benefits because it is a rare small business indeed that is able to support the entire range of benefits that would be typically offered by the larger or older enterprises. We believe this sense of restraint is also necessary in connection with Social Security. It is obvious that all of us could think of larger or more extensive benefits for Social Security and all of them might be desirable, but the line must be drawn at the point where we become unwilling or unable to pay for them. We believe that time has already come because the benefits promised in the 1972 Social Security Amendments are simply proving to be more than we can support financially, and the chief cause is the excessive adjustment for inflation which was included in Social Security in 1972. We believe, therefore, that perhaps the most important aspect of the current legislative proposals is the correction of the Social Security benefit formula to eliminate the double adjustment for inflation and to "decouple" the program and we support this wholeheartedly.

Background

In May, 1977, President Carter sent to Congress a legislative package dealing with the Social Security problems. The principal proposals were:

(1) Institute countercyclical general revenue financing to replace lost taxes when unemployment exceeds 6 percent;

(2) Remove the ceiling on the amount of an employee's pay on which the employer pays Social Security taxes;

(3) Increase the self-employed tax rate to the traditional level of 1½ times the tax on employees;

(4) Shift some funds from the Hospital Insurance trust fund to the Old Age fund;

(5) Add $600 to the wage base otherwise effective in each of four years, 1979, '81, '83 and '85;

(6) Change the dependency test in conformity with recent Supreme Court decisions requiring men and women to be treated equally;

(7) Modify the Social Security benefit formula to eliminate the inflation over-adjustment now in the law—usually referred to as "decoupling";

(8) Advance to 1985 and 1990 the 1% increase in tax scheduled to go into effect in 2011.

NECESSARY CHANGES

Certain of the foregoing proposals are desirable and indeed necessary in order to preserve the financial soundness of the Social Security System. It is absolutely necessary to adopt a decoupling amendment. It is most desirable to restore the traditional 1½ times tax for self-employed workers. Because of recent Supreme Court decisions, it is also necessary to change the dependency test to conform with current legal requirements. These changes (3, 6, and 7 above) clearly should be adopted and adopted promptly.

UNDESIRABLE CHANGES

Small business opposes two of the proposals as being completely undesirable because they violate the fundamental principle on which the Social Security program is based. The proposal to eliminate the ceiling on an individual worker's wages on which the employer must pay tax would destroy the 50–50 cost sharing principle. The proposal to institute countercyclical general revenue financing is only needed if Social Security is underfinanced and imposes a financing burden on general revenues at precisely the wrong time. We are unalterably opposed to these two changes (1 and 2 above).

UNLIMITED EMPLOYER TAXES

The proposal to remove the ceiling on the amount of an employee's pay on which the employer must pay Social Security tax is unsound and unwise. When fully phased-in by 1982, this proposal is supposed to develop an additional $11.4 billion of taxes out of the grand total of $13.1 billion of new revenue in that year from all of the President's proposals. In short, this one proposal accounts for 87 percent of the new financial support. If employees are unwilling to pay an increased tax to support Social Security, why should any additional burden be put on their employer or even on some other employer? Up to now, the 50–50 matching has allocated Social Security costs to the employees whose wage records are covered for benefit purposes and to their employers. The costs have been allocated roughly in the proportion to which the employees can anticipate benefits from the system. On the other hand, this particular tax on earnings above the Social Security wage base would add no burden whatever to the small employer in an industry with low-paid employees and yet it could increase Social Security taxes by as much as 100 percent on small employers in high-technology industries. If additional financing is required for the Social Security System, it is just not right to try and unload it on some of the employers while other employers and all employees get off scot-free. All employees earning up to the Social Security tax base are now promised benefits based on their pay up to that tax base and if those benefits cost more than is now being paid into the system in taxes, the added cost should be borne by all of them and by all employers and not passed on only to the employers of higher-paid people. If the benefits are for everyone, the cost should be shared by everyone.

We can understand the general attitude of some groups in looking at this added tax. There is always the hope that the burden can be placed on somebody else's shoulders and the idea of passing the Social Security cost on to the big corporations who pay their executives large amounts, looks like an easy solution. Small business opposes this solution, however, because it would hurt the high-technology companies in aerospace and computer applications, in xerography and communications and most of them are small businesses. It would impose a heavier Social Security tax burden on companies employing engineers and scientists, computer experts and chemists, mathematicians and research personnel. In short, it would impose an unfair tax burden on the leading edge of the American industrial complex and that is just the wrong place to discourage future activity.

Small businesses are usually started by a few owner-managers who risk their own capital and contribute their own efforts. In the early years of most small businesses, there is not enough in the way of earnings, or no profits at all, and the businesses cannot obtain sufficient credit so that the end result is that the owner-managers underpay themselves. In a sense this is their investment in the business. When the financial rewards do come, there are two ways the owner-manager can get them:

(1) by way of dividends on their stock, and the Federal Government is already taxing that form of income twice; and

(2) in the form of higher salary and now we have before us a proposed 6% whack on that in order to bail out the Social Security System.

This proposal clearly discriminates against small businesses and the people who start them up.

Not only does this proposal put the burden in the wrong place, it distorts the balance in the Social Security System in ways which may be unintended. Here are two illustrations of some unintended side effects: First, from time to time,

Congress has raised the Social Security wage base and this not only raises the level upon which benefits are based but also increases the level of wages on which taxes will be collected from both employer and employee. If the ceiling on the amount of pay on which the employer's Social Security tax is levied were to be removed, then any future proposal to increase the wage base will bring with it the same benefit improvement as in the past but only half of the added revenue since the employer's portion of the tax on the additional earnings will have already been anticipated by this 1977 proposal. In effect, we are counting as future income the employer's portion of the tax involved in future wage base amendments in advance of the amendments themselves. The employer's tax on wages over the Social Security tax base should be used as income to the system only if and when the tax base is raised. If we collect the taxes before that time, then it will be much more costly to raise the wage base if that should ever be desirable at some future date.

A second illustration of the distortion of the program is the impact on certain special groups such as public school teachers. While public school systems employ many lower-paid individuals, the salaries paid to public school teachers are set at a level appropriate for professionals and rise in proportion to service and additional education. In the case of a typical New York State School District, more than half of the teachers having five years of service have scheduled pay in excess of the Social Security tax base. These public school systems have the choice of remaining in the Social Security System or leaving it. To impose added taxes on such school districts without any evident increase in benefit would merely encourage more such systems to withdraw from Social Security. The problem is even worse because teachers' salaries are greatest in the school systems operated by the major cities and least in the rural areas. Therefore, the added burden would fall on systems like the New York City Public Schools and certainly would make the alternative of dropping out of Social Security that much more attractive to them.

POSITION

Small business is fundamentally opposed to the proposal to tax employers on total payrolls because it is not right. If the present Social Security System needs more money, it should get it from the employees who are covered by the system and their employers will match the added tax dollar for dollar.

COUNTERCYCLICAL USE OF GENERAL REVENUES

One of the proposals to fix up Social Security financing would draw on general revenues whenever unemployment exceeds 6 percent. As the proposal is drawn, it would appear to be limited to the years 1975–78, with the cash actually being transferred to the Social Security funds in the years 1978, 1979, and 1980. This proposal is obviously aimed at the short-term financial difficulties. It is hard to see how this could actually help the situation in the long run. If the general revenue burden is included in years of high unemployment, it would merely increase the national debt and not the actual financing of Social Security since there will already be budget deficits in those years. Even more to the point, however, by imposing added general revenue costs in bad business years, the demand on general revenue could not come at a worse time because it will reduce the government's ability to adopt financial solutions to alleviate unemployment or to help small businesses. We believe it is very poor financial planning for the government to undertake to support the Social Security program only in those years when there is likely to be a maximum demand on government to support the unemployed directly or to assist small businesses that are failing or in dire financial straits. It obviously would be far smarter for us to set the level of Social Security financing at a point where, on the average, it will support the system over a long period of years consisting of both good years and bad years. This is true countercyclical financing because the system in good years could then build up trust fund balances that would support the system when employment falls off.

POSITION

Small business opposes the proposal to use general revenues countercyclically for Social Security financing. When times are bad, government programs to

help small businesses should be expanded and any requirement to support Social Security from general revenues in those same periods will just get in the way.

OTHER PROPOSALS

The other proposals which have been made (4, 5, and 8 in the list) do not appear to be immediately necessary and they appear to be cosmetic rather than substantive.

The proposal to shift monies from the Hospital Insurance trust fund to the Retirement trust funds clearly leaves the total Social Security trust funds in the same position they were in before the shifting. Apparently, the reason for this proposed shift is that it is hoped that current proposals to control hospital costs will work better than the methods we have used in the past to control hospital costs. Small business is skeptical about spending future savings before it is sure that the savings will actually be there.

The proposal to take the rate increase included in the present law for the year 2011 and advance it to the years 1985 and 1990 would help make things "seem right" in 1977. On the other hand, not one cent of additional income will be received by the trust funds until 1985. We seriously question whether it is wise to pay high benefits now if we are only willing to increase taxes 10 years in the future. It does not appear to be a sound approach.

The proposal to provide for several $600 increases in the wage base at two year intervals from 1979 through 1985 will increase both the tax receipts and the benefits paid by the system, but, of course, the effect on taxes will be earlier and this will help the short-term cash shortage. For the long-run, if the taxes are set at a level where they support the benefits, there will not be too much financial help to Social Security in raising the tax base. It does not make much sense to take on bigger benefits permanently just because the earlier payment of the increased taxs will help out in a short-run financial squeeze.

Position

We recommend that these proposals be referred to the next Social Security Advisory Council for their study and analysis.

GENERAL APPROACH

Small businesses and their employees are counting on Social Security to work out right in the long run. We do not believe that Congress should take the easy way out by tinkering around with the financing of the Social Security System in an effort to make things seem right. Indeed, some of the proposals resemble the imaginative accounting solutions adopted by New York City to make their books look better. What is needed is more of a cash on the barrel-head approach that sets the benefits at a level which the tax-paying employees are willing to support. The small businesses who employ them have accepted the obligation to match those taxes dollar for dollar. Small businesses and most private families too, all have learned the hard way that our ability to pay is a good deal less than our ability to think up things which we have to have.

DECOUPLING

We support wholeheartedly a change in the Social Security System today that would decouple benefits and leave them at a level which can be supported in the long run. There have been a number of specific proposals as to just how this is to be done, but we suggest that the process should go further. Specifically, the wage records of the individuals covered by the Social Security System should be adjusted in such a manner that when they retire their benefits will not have been lost through inflation. In addition, we recommend that this adjustment should be such that the generous benefits for employees with low earnings will in fact be limited to full-time employees with low average pay or lower-paid employees with long periods of sporadic earnings that are consistently low.

Part of the financial deficit in the Social Security System is due to employees of the Federal Government who are covered by a generous Civil Service Retirement System but who, after their retirement, work a few years in Social Security employment (or who moonlight for a few years during their Federal

careers). These "double-dippers" now end up with low-average earnings and thus make off with the generous benefits that were intended for the regular low-paid worker. Small businesses, many of whom cannot afford their own private pension plans, should not be expected to pay taxes to support these added, and undeserved, Social Security benefits on top of the Civil Service Retirement System. This loophole should be corrected now.

CONCLUSION

The Small Business Legislative Council supports all efforts to put the Social Security System on a sound financial basis. We do not support approaches which merely make things seem right at the moment or approaches which attempt to pass the burden on to some special group or other. If taxes must be raised, then they should be raised now. On the other hand, if employees are not willing to pay greater Social Security taxes to cover the costs of the present program when their tax dollars are matched by their employers' taxes, then we believe the Social Security benefit level has already gone beyond the point of self-support. If that should be the case, we believe the benefit increases built into the system for the future should be reduced to bring the Social Security program back into financial balance. We do not believe that general revenues should be relied upon just because that seems to be an easy way out. In addition, we believe the countercyclical proposal should be abandoned because Social Security financing is already countercyclical in the sense that the burden rises and falls with the number of workers employed. In the long run, we will all be better off setting the level of Social Security taxes at a point which will support the system in good years and bad. Then any surplus developed in the good years can be held in the trust funds to meet the tax shortfalls in bad years.

The Small Business Legislative Council recommends, therefore, that the decoupling amendments be adopted now, that the self-employed tax be set at 150 percent and that the dependency test proposal be put into effect. As for the rest of the proposed changes, we believe that all of them should be referred to the next Social Security Advisory Council for thorough and careful review. Our final recommendation is that the program should continue to be financed 50–50 by employee and employer alike and that any current financial weakness in the Social Security System should be corrected by a prompt adjustment in either the level of contribution or the level of benefits. Above all, we want to avoid political tinkering at two or four year intervals. We do not need brainstorming and novel ideas. What we want are time-tested approaches and reasoned judgment. For our part, we need and will support a soundly designed and financed Social Security program because our employees depend upon it so heavily.

Thank you.

117 organizations, with more than 344,000 small business firms as members, support in principle the Small Business Legislative Council policy position on Social Security Financing Proposals. These are:

Alaska Retail Association, Anchorage, AK.
American Association of Meat Processors, Elizabethtown, PA.
American Fishing Tackle Manufacturers Association, Chicago, IL.
American Machine Tool Distributors Association, Washington, D.C.
American Subcontractors Association, Washington, D.C.
Associated Master Barbers & Beauticians of America, Charlotte, NC.
Automotive Wholesalers Association of New England, Peterborough, NH.
Casket Manufacturers Association, Evanston, IL.
American Academy of Environmental Engineers, Rockville, MD.
American Association of Nurserymen, Washington, D.C.
American Land Development Association, Washington, D.C.
American Pipe Fittings Association, Stamford, CT.
Arkansas Retail Merchants Association, Little Rock, AR.
Automotive Engine Rebuilders Association, Glenview, IL.
Building Service Contractors Association, McLean, VA.
Christian Booksellers Association, Colorado Springs, CO.
Cigar Association of America, Inc., Washington, D.C.
Computer & Communications Industry Association, Arlington, VA.
Cutting Tool Manufacturers Association, Birmingham, MI.

Engraved Stationery Manufacturers Association, Chicago, IL.
Food Merchandisers of America, Washington, D.C.
FoodService Equipment Association, Chicago, IL.
Independent Media Producers Association, Washington, D.C.
Independent Sewing Machine Dealers Association, Hilliard, OH.
Kentucky Small Business Association, Louisville, KY.
Machinery Dealers National Association, Silver Spring, MD.
Manufacturers Association of Delaware Valley, Norristown, PA.
Menswear Retailers of America, Washington, D.C.
Michigan Grain & Agri-Dealers Association, Saginaw, MI.
Missouri Agricultural Industries Council, Inc., Kansas City, MO.
Narrow Fabrics Institute, New Rochelle, NY.
National Art Materials Trade Association, Hasbrouck Heights, NJ.
National Association of Floor Covering Distributors, Chicago, IL.
Connecticut Small Business Federation, Hartford, CT.
Council of Construction Employers, Inc., Washington, D.C.
Delaware Valley Automobile Dealers Association, Philadelphia, PA.
Energy Products and Services Association, San Diego, CA.
Farmers Elevator Association of Minnesota, Minneapolis, MN.
Food Processing Machinery & Supplies Association, Washington, D.C.
Independent Bakers Association, Washington, D.C.
Independent Battery Manufacturers Association, Inc., Largo, FL.
Independent Petroleum Association of America, Washington, D.C.
International Association of Wall & Ceiling Contractors/Gypsum Drywall Contractors International, Washington, D.C.
Louisiana Wholesale Grocers' Association, Inc., Baton Rouge, LA.
Manufacturers Agents National Association, Irvine, CA.
Massachusetts' Businessman's Association, Braintree, MA.
Metal Ladder Manufacturers Association, Greenville, PA.
Minnesota Motorcycle Dealers Association, Minneapolis, MN.
Minnesota Nurserymen's Association, St. Paul, MN.
Moving Agents & Drivers of America, Inc., Baltimore, MD.
National Appliance Service Association, Kansas City, MO.
National Association of Business & Educational Radio, Inc., Washington, D.C
National Association of Fruits, Flavors, & Syrups, Inc., Lake Success, NY.
National Association of Glove Manufacturers, Inc., Gloversville, NY.
National Association of Independent Lumbermen, Washington, D.C.
National Association of Life Underwriters, Washington, D.C.
National Association of Tobacco Distributors, New York, NY.
National Beer Wholesalers Association, Chicago, IL.
National Candy Wholesalers Association, Washington, D.C.
National Confectionery Salesmen's Association of America, Inc., New Monmouth, NJ.
National Employment Association, Washington, D.C.
National Family Business Council, Westville, NJ.
National Home Improvement Council, New York, NY.
National Independent Meat Packers Association, Washington, D.C.
National Lumber & Building Material Dealers Association, Washington, D.C.
National Office Products Association, Alexandria, VA.
National Patent Council, Arlington, VA.
National Pest Control Association, Vienna, VA.
National Screw Machine Products Association, Cleveland, OH.
National Small Business Association, Washington, D.C.
National Tool, Die, & Precision Machining Association, Washington, D.C.
National Tour Brokers Association, Lexington, KY.
National Association of Home Manufacturers, Washington, D.C.
National Association of Plastic Fabricators, Washington, D.C.
National Association of Plumbing/Heating/Cooling Contractors, Washington, D.C.
National Bankers Association, Washington, D.C.
National Building Material Distributors Association, Chicago, IL.
National Concrete Masonry Association, McLean, VA.
National Electrical Contractors Association, Bethesda, MD.
National Environmental Systems Contractors Association, Arlington, VA.

National Hearing Aid Society, Livonia, MI.
National Home Furnishings Association, Washington, D.C.
National Independent Dairies Association, Washington, D.C.
National Labor-Management Foundation, Louisville, KY.
National Office Machine Dealers Association, Hackensack, NJ.
National Oil Jobbers Council, Washington, D.C.
National Parking Association, Washington, D.C.
National Peach Council, Martinsburg, WV.
National Retail Hardware Association, Indianapolis, IN.
National Silo Association, Inc., Waterloo, IA.
National Tire Dealers & Retreaders Association, Washington, D.C.
New Jersey Tool, Die & Precision Machining Association, Denville, NJ.
Northeastern Lumber Manufacturers Association, Falmouth, ME.
Ohio Nurserymen's Association, Columbus, OH.
Oregon Feed, Seed and Suppliers Association, Portland, OR.
Photo Marketing Association, Jackson, MI.
Retail Floorcovering Institute, Chicago, IL.
Rocky Mountain Food Dealers Association, Denver, CO.
Small Business Service Contractors Association, Washington, D.C.
Terminal Elevator Grain Merchants Association, Minneapolis, MN.
The Valley of Virginia Co-operative Milk Producers Association, Harrisonburg, VA.
Western Home Furnishings Association, Los Angeles, CA.
Northwest Country Elevator Association, Minneapolis, MN.
Oil Jobbers of Wisconsin, Madison, WI.
Oregon Association of Nurserymen, Portland, OR.
Pacific Coast Meat Association, San Francisco, CA.
Pacific Northwest Grain Dealers Association, Inc., Portland, OR.
Printing Industries of America, Arlington, VA.
Retail Jewelers of America, West Orange, NJ.
Schiffli Lace & Embroiders Manufacturers Association, Union City, NJ.
Sheet Metal & Air Conditioning Contractors National Association, Vienna, VA.
South Carolina Merchants Association, Columbia, SC.
South Dakota Retailers Association, Pierre, S.D.
Toledo Area Small Business Association, Toledo, OH.
Truck Body and Equipment Association, Washington, D.C.
Vermont Plantsmen's Association, Inc., Reading, VT.
Wisconsin Association of Food Dealers, Madison, WI.

Senator NELSON. We will recess for about 10 minutes.

[A brief recess was taken.]

Senator NELSON. Our next witness is Mr. Robert Myers, appearing on behalf of the American Council of Life Insurance.

Mr. Myers, the committee is pleased to see you back again and to get the benefit of your thoughtful commentary. Your statement will be printed in full in the record. You may present it however you may desire.

STATEMENT OF ROBERT J. MYERS ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE

Mr. MYERS. Thank you, Mr. Chairman. I will present a condensation of the statement.

My name is Robert J. Myers, and I am appearing here today on behalf of the American Council of Life Insurance. Ever since the inception of the social security program, the life insurance business has supported this program. The life insurance business at times has criticized certain social security legislative proposals when they were not believed to be in the best interests of the country.

The life insurance business believes that the best interests of the people in the country and of the Nation itself are served if social security does not expand beyond a floor-of-protection level. Accordingly, social security should not encroach on the resources available to the private sector by having an inordinately high benefit level or an inordinately high maximum taxable earnings base. In the same manner, social security should not be overused as an antipoverty weapon, thus supplanting the public assistance tier and overburdening the payroll tax.

We have studied with much interest the social security financing proposals of the Carter administration, which were presented by Secretary Califano to your subcommittee in the hearings held on July 13. We are pleased that the administration has recognized the serious financing problems confronting the social security program and is so promptly and strongly concerned about restoring its financial integrity.

Before presenting detailed comments on these proposals, I would like to emphasize that the American Council of Life Insurance believes that a fundamental solution to most of the financial problems of the social security system could be achieved by a relatively small number of direct measures. Specifically, we support an immediate increase of 0.5 percent in the tax rate on both employers and employees, and an additional increase of one-quarter percent in these tax rates in the 1980's.

This, together with the decoupling procedure we recommend, an increase in the tax rate on the self-employed to the traditional ratio of 1½ times the tax rate on employees, and the administration's proposal to provide a new test for dependent's benefits, which we support, would be sufficient to stabilize the social security trust funds for the next 30 years. For subsequent years, the financing needs will depend to a considerable extent on future trends as to such elements as birth rates and retirement rates which should be much more discernible as time passes.

Let me now turn to each of the changes proposed by the administration.

I. Financing from general revenues during times of high unemployment. We strongly oppose this proposal, because we believe that any injection of a Government subsidy on an ongoing basis into the social security system is undesirable. Such a procedure does not make clear to the general public what the true costs of social security really are and thus could lead to unwise overexpansion of the system. The time-tested method of financing the program on a self-supporting basis, without a Government subsidy, should be continued.

Moreover, this proposal is faulty because it is difficult, if not impossible, to compute with any precision exactly how much the reduction in social security taxes is because of unemployment in excess of 6 percent. I believe the estimate of the administration is far too high.

II. Taxing employers on the entire wages of employees. This proposal would eliminate, in steps, the maximum limit on taxable earnings insofar as it applies to the employer tax. The complete elimination of the maximum limit would be applicable after 1980.

We believe that such a change is very undesirable, because the present procedure of equal payments by the employer and the employee that has been followed ever since the system began seems fair and appropriate to all parties concerned. Moreover, this approach results in inconsistent treatment as between self-employed persons and individuals in a similar position who have incorporated their small business.

Further, it should be clearly realized that the payment of the much larger social security taxes by employers will very likely not be absorbed by them, but rather may well be passed on to the general public in the form of higher prices or else to the employees in the form of lower wages than they would otherwise have had. At the same time, any additional large employer cost such as this will very likely result in less funds being available for provision of economic security through the private sector, such as under pension plans.

The administration has stated that the increased cost to employers for this proposal to eliminate the maximum limit on taxable earnings for their payroll taxes would have a slightly lower cost in 1979–82 than under the so-called conventional financing approach of raising both the tax rate and the earnings base to a greater extent than the automatic-adjustment provisions would do.

First. I do not agree that this is the conventional financing approach. Rather, the conventional approach has been solely to increase tax rates.

Second, I cannot agree with this analysis because it involves so-called savings by drawing down the trust funds and by making available a Government subsidy—which, in turn, would likely be derived in considerable part from other taxes on employers.

III. Restoring traditional ratio for tax on self-employed. We support this proposal as a desirable and consistent one.

IV. Shifts in allocation of tax rates among trust funds. We do not favor the shift of part of the presently scheduled HI tax rates to OASDI. The 1977 HI Trustees Report shows that, under the intermediate estimate, the HI program has a lack of actuarial balance of 1.16 percent of taxable payroll over only the next 25 years and that the HI Trust Fund will be exhausted by the late 1980's. In fact, the Board of Trustees recommended that "action be taken in the near future to strengthen the financing of the hospital insurance system."

The administration justified this proposal in part on the expectation that its program to contain the rate of increase in hospital costs will be enacted. It would seem only prudent to take such a factor into account after the legislation involved is enacted and after the actual experience shows that the program is effective.

The administration also proposed that the allocation of the combined employer-employee tax rate for OASDI should be changed. beginning in 1978, so as to give a larger proportion to the DI Trust Fund. We agree that DI should have a proportionately larger share of the total. We favor giving DI a larger proportionate amount of the increase in the OASDI tax rate which we recommend than prevails in the present allocation.

V. Increases in employee and self-employed earnings base subject to tax. We believe that such a change is most undesirable. The earn-

ings base is not primarily a financing mechanism, but rather it serves to define the scope of the program and, correspondingly, the role that the private sector should play in providing economic security. An increase in the earnings base beyond what would be provided by the automatic-adjustment provisions will undesirably narrow the responsibility of the private sector in the economic security field.

Moreover, increasing the base insofar as it relates to workers does not provide any significant additional financing over the long range, because the additional taxes collected are very closely offset by the additional benefit liabilities created.

VI. Change in test for dependent beneficiaries. We support this change, which is both innovative and reasonable. In fact, we believe that further action in this area might be considered at this time, to prevent the windfall benefits which now occur for spouses who do not qualify for social security benefits on the basis of their own earnings and who have pensions as governmental employees. The Advisory Council on Social Security recommended that such Government-employee pensions should be considered as an offset against spouse's benefits under social security.

VII. Correcting inflation overadjustment in initial compensation of benefits. We are strongly in favor of the general principle of decoupling by the wage-indexing approach as is done under the administration proposal, but we believe that the ultimate level of the replacement ratios should be about 10 percent lower relatively than those currently emerging and, instead, should be at about the level prevailing before 1972. Our belief is based on the facts that the benefit level was overexpanded in 1969–72 and that there has been a continuing lag in instituting decoupling.

Our decoupling approach would decrease even more the long-range deficit of the social security system and thus come much closer to restoring its financial integrity. We also propose a permanent savings clause for retirement benefits that would utilize the benefit formula under present law as that formula would stand just before the new decoupling procedure would go into effect if it produces a larger amount. Thus, there would be a gradual phasing in to the benefit level that we recommend.

We strongly support the administration's proposal that the savings clause or transitional provision apply only to retirement cases, and not to disability or young-survivor benefits. This will go a long way toward eliminating the anomalous situation in present law whereby, in such cases, the benefits payable exceed the net take-home pay of the insured worker. Consideration should also be given to imposing a percentage-of-prior-earnings cap on the benefits of disabled workers and their dependents. The Health Insurance Association of America, which has great interest in this area, also holds these views.

We would also continue unchanged the present procedure for adjusting automatically benefits for those on the rolls to reflect increases in the cost of living. Accordingly, all beneficiaries would have not only the dollar amount of their benefits safeguarded, but also the purchasing power of the benefits.

The specific benefit formula that we recommend in connection with the decoupling bill of the Ford administration last year was based

on its becoming first effective in 1978. We still would like to see such an effective date. Of course, if the effective date were to be later, appropriate changes would be necessary. Also, there were a number of essentially technical changes that we would have liked to have seen in the Ford administration bill, and it may well be that, when the Carter administration bill is available, we will have some technical comments.

VIII. Advancing planned increase in tax rate from 2011 to 1985 and 1990. We believe that the only proper way to obtain additional financing for the social security program—other than through reducing benefit costs where these are now irrationally high and overly liberal, or where they provide undue windfalls—is through the clearly visible method of increasing the tax rates.

In other words, we are opposed to injecting a Government subsidy or to increasing the maximum taxable earnings base more than the automatic adjustment provisions will do. Accordingly, we support the general principle of this proposed change of increasing the tax rates, although we would go further by instituting increases at an earlier date than 1985—in fact, as early as 1978 or, at the latest, 1979.

Next, let me set forth the cost effects of our proposals over both the short range and the long range. Tables 1 and 2 attached to my statement, which I request be included in the record, demonstrate clearly that our proposals will, solely from a financial standpoint, solve the short-range and medium-range financing problems as well as will the administration proposals. For the OASDI system combined, for the 5-year period 1978–82, the additional income under our proposals, including the additional interest earnings of the trust fund, is estimated at $66.3 billion, while the lessened outgo is estimated at $10.5 billion. Thus, the net result is an increase in the trust-fund balances of $76.8 billion over what would occur if present law were left unchanged. As a result, the trust-fund balance at the end of 1982 would be $62 billion, instead of in a deficit position of $14.8 billion. The breakdown of these figures is shown in table 1.

Then, as to the medium-range financial situation—the next 25 years—our proposals are estimated to result in an average excess of annual income over disbursements averaging 0.4 percent of taxable payroll. As a result, the system would have adequate financial resources to meet anticipated disbursements for this 25-year period and to build up the trust-fund balances. Table 2 presents the details of this situation.

Finally, as to the long-range financial situation, our proposals would result in reducing the estimated average deficiency for the 75-year period beginning 1977 from 8.2 percent of taxable payroll to only 1.2 percent. Recognizing the difficulties of forecasting precisely for such periods and the variations possible as a result of, for example, birth rates and retirement rates, this is a reasonably satisfactory situation, and the deficiency then is in more reasonably manageable proportions.

I would like now to comment on a bill now pending before the House of Representatives; namely, H.R. 3363. This bill would remedy a longstanding inequity in the collection of duplicate taxes under social security and under unemployment insurance for certain concurrent employers of the same employee.

Under such circumstances, the employee is really in effect in only one job, and it seems only fair that the concurrent employers together should not pay on more than the maximum taxable wage base. Such treatment has, for many years, been accorded to successor corporations under section 3121(a)(1) of the Internal Revenue Code and to State agencies or State-paid employees of political subdivisions under section 218(e)(2) of the Social Security Act. We strongly urge legislative enactment of the provisions contained in H.R. 3363.

In closing, I should like to reiterate the strong support of the American Council of Life Insurance for our Nation's social security program. We believe that it should provide an adequate, viable, and sound floor of protection in the economic security area of retirement, long-term disability, and death of the breadwinner. The time-tested method of financing social security on a self-supporting basis, without a Government subsidy and with a maximum taxable earnings base consistent with those prevailing in the last quarter century, should be continued.

We urge that action should be taken this year to strengthen the fiscal integrity of the social security system by decoupling the benefit computation for new claimants under the wage-indexing approach. We also urge that suitable action should be taken to strengthen the financing of the system, especially in the short range, by an immediate moderate increase in the employer-employee tax rates. The restoration of public confidence in the social security program requires no less.

Senator NELSON. Thank you very much for your very thoughtful commentary on the administration proposal. We appreciate your taking the time to appear today.

I am not taking much time for questions because we have a 2-hour limit of time in which to meet, and we have to conclude. If we have further questions—which we will, after we review all of the testimony—I assume you would be willing to respond in writing.

Mr. MYERS. Yes, indeed, Mr. Chairman. I would be very happy to do so for you or your staff.

Senator NELSON. You said you may at least offer some technical amendments when the legislation is introduced, which will be on Tuesday next.

Mr. MYERS. I will be very happy, on behalf of the American Council of Life Insurance, to write a technical memorandum on that, as I did on the previous bill.

Senator NELSON. We would appreciate having it. The bill will be in the Tuesday Congressional Record. You can get it from our office that day, or Wednesday.

Mr. MYERS. Thank you, Mr. Chairman.

Senator NELSON. Thank you.

[The prepared statement and memorandum of Mr. Myers follows. Oral testimony continues on p. 346.]

STATEMENT OF ROBERT J. MYERS ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE

Mr. Chairman and members of the subcommittee: My name is Robert J. Myers, and I am appearing here today on behalf of the American Council of Life Insurance. The 470 life insurance companies which comprise the membership of the Council account for about 92 percent of the total life insurance in

force in the United States and about 99 percent of the assets attributable to insured qualified pension and profit-sharing plans.

Before discussing the proposals of the Administration, I should like to point out that, ever since the inception of the Social Security program in 1935, the life insurance business has supported this program. The life insurance business has at times criticized certain Social Security legislative proposals when they were not believed to be in the best interests of the country.

The life insurance business believes that economic security for the people of our Nation should be provided from three sources. First, the government, through Social Security, should provide a floor of protection which is universally applicable, on a compulsory basis. Second, there should be private sector initiatives on a voluntary and flexible basis, through both individual and employer efforts, in the form of home ownership, savings and investments, private pension and profit-sharing plans, and insurance. Third, in the relatively small proportion of cases where the first two tiers do not provide adequate income, then public assistance programs such as Supplemental Security Income should make up the necessary difference.

The life insurance business believes that the best interests of the people of the country and of the Nation itself are served if Social Security does not expand beyond a floor-of-protection level. Accordingly, Social Security should not encroach on the resources available to the private-sector tier by having an inordinately high benefit level or an inordinately high maximum taxable earnings base. In the same manner, Social Security should not be overused as an anti-poverty weapon, thus supplanting the public assistance tier and overburdening the payroll tax.

The Old-Age, Survivors, and Disability Insurance system, which is commonly referred to as Social Security, currently has some very serious financing problems. Some of these problems are of short-range nature, while others are of a long-range nature.

We have studied with much interest the Social Security financing proposals of the Carter Administration, which were presented by Secretary Califano to your subcommittee in the hearings held on July 13. We are pleased that the Administration has recognized the serious financing problems confronting the Social Security program and is so promptly and strongly concerned about restoring its financial integrity. The Administration proposal involves eight different changes which seek to solve the short-range cash-flow problem now present and to substantially reduce the long-range actuarial deficit. We agree completely with several of these proposed changes, but there are some on which we take a quite different position.

Before presenting detailed comments on these proposals, I would like to emphasize that the American Council of Life Insurance believes that a fundamental solution to most of the financial problems of the Social Security system could be achieved by a relatively small number of direct measures. Specifically, we support an immediate increase of 0.5 percent in the tax rate on both employers and employees and an additional increase of one-quarter percent in these tax rates in the 1980's. This together with the decoupling procedure we recommend, an increase in the tax rate on the self-employed to the traditional ration of 1½ times the tax rate on employees, and the Administration's proposal to provide a new test for dependent's benefits, which we support, would be sufficient to stabilize the Social Security trust funds for the next 30 years. For subsequent years, the financing needs will depend to a considerable extent on future trends as to such elements as birth rates and retirement rates which should be much more discernible as time passes.

Let me now turn to each of the changes proposed by the Administration.

I. FINANCING FROM GENERAL REVENUES DURING TIMES OF HIGH UNEMPLOYMENT

This proposal would provide a government subsidy from general revenues to make up for the loss of Social Security taxes in 1975–78 because the unemployment rate has been in excess of 6 percent since 1975 and is expected to be so through 1978. Although the proposal is for only this limited, temporary period, it is likely that, if once enacted, it would later be extended.

We strongly oppose this proposal, because we believe that any injection of a government subsidy on an ongoing basis into the Social Security system is

undesirable. Such a procedure does not make clear to the general public what the true costs of Social Security really are and thus could lead to unwise over-expansion of the system. The time-tested method of financing the program on a self-supporting basis, without a government subsidy, should be continued.

Moreover, this proposal is faulty because it is difficult, if not impossible, to compute with any precision exactly how much the reduction in Social Security taxes is because of unemployment in excess of 6 percent.

The procedure actually followed by the Administration in developing the estimated figure of a $14.1 billion tax loss is subject to considerable question. It is by no means as precise as are the several computations now involved in the Social Security Act in connection with the automatic adjustments of the benefit amounts, the maximum taxable earnings base, and the exempt amounts of earnings under the retirement test or in connection with the cost-sharing amounts under Medicare. I believe that this estimated figure is far too high.

II. TAXING EMPLOYERS ON THE ENTIRE WAGES OF EMPLOYEES

This proposal would eliminate, in steps, the maximum limit on taxable earnings insofar as it applies to the employer tax. The complete elimination of the maximum limit would be applicable after 1980.

We believe that such a change is very undesirable, because the present procedure of equal payments by the employer and the employee that has been followed ever since the system began seems fair and appropriate to all parties concerned. Moreover, this approach results in inconsistent treatment as between self-employed persons and individuals in a similar position who have incorporated their small business.

Further, it should be clearly realized that the payment of the much larger Social Security taxes by employers will very likely not be absorbed by them, but rather may well be passed on to the general public in the form of higher prices or else to the employees in the form of lower wages than they would otherwise have had. At the same time, any additional large employer cost such as this will very likely result in less funds being available for provision of economic security through the private sector, such as under pension plans.

The Administration has stated that the increased cost to employers for this proposal to eliminate the maximum limit on taxable earnings for their payroll taxes would have a slightly lower cost in 1979–82 than under the so-called conventional financing approach of raising both the tax rate and the earnings base to a greater extent than the automatic-adjustment provisions would do. First, I do not agree that this is the conventional financing approach. Rather, the conventional approach has been solely to increase tax rates. Second, I cannot agree with this analysis because it involves a so-called "savings" by drawing down the trust funds and by making available a government subsidy—which, in turn, would likely be derived in considerable part from other taxes on employers. It also seems strange to refer to a reduction in the size of the trust funds as a "savings". Drawing down the trust funds cannot properly be considered as involving a decrease in taxes otherwise necessary, because more payroll taxes will be needed later and there will be less invstment incom from the trust funds.

III. RESTORING TRADITIONAL RATIO FOR TAX ON SELF-EMPLOYED

This proposal would restore, beginning in 1979, the historical relationship of the self-employed tax for Old-Age, Survivors, and Disability Insurance (OASDI), namely, a rate equal to 1½ times the employee rate. Legislation in 1965 limited the self-employed rate to a maximum of 7 percent, which was first reached in 1973.

We support this proposal as a desirable and consistent one.

IV. SHIFTS IN ALLOCATION OF TAX RATES AMONG TRUST FUNDS

This proposal would shift a part of the presently scheduled tax rates for the Hospital Insurance program (HI) to OASDI. Specifically, as to the HI tax rate for employers, employees, and the self-employed (all of which are the same), 0.1 percent of the 0.2 percent increase scheduled for 1978 would be shifted to OASDI, and 0.1 percent of the 0.25 percent scheduled for 1981 would be so shifted.

We do not favor this change. The 1977 HI Trustees Report shows that, under the intermediate estimate, the HI program has a lack of actuarial balance of 1.16 percent of taxable payroll over only the next 25 years and that the HI Trust Fund will be exhausted by the late 1980's. In fact, the Board of Trustees recommended that "action be taken in the near future to strengthen the financing of the hospital insurance system".

The Administration justified this proposal in part on the expectation that the Administration's program to contain the rate of increase in hospital costs will be enacted. It would seem only prudent to take such a factor into account after the legislation involved is enacted and after the actual experience shows that the program is effective.

The Administration also proposed that the allocation of the combined employer-employee tax rate for OASDI should be changed, beginning in 1978, so as to give a large proportion to the DI Trust Fund. We agree that DI should have a proportionately larger share of the total. We would achieve this result by giving DI a larger proportionate amount of the increase in the OASDI tax rate which we recommend than prevails in the present allocation of the OASDI tax rate.

V. INCREASE IN EMPLOYEE AND SELF-EMPLOYED EARNINGS BASE SUBJECT TO TAX

This proposal would increase the maximum taxable and creditable earnings base for employees and the self-employed by $600 more than the automatic-adjustment provisions would do in each of four years 1979, 1981, 1983, and 1985. The argument made by the Administration for this change is that it would provide additional revenues for financing purposes.

We believe that such a change is most undesirable. The earnings base is not primarily a financing mechanism, but rather it serves to define the scope of the program and, correspondingly, the role that the private sector should play in providing economic security. An increase in the earnings base beyond what would be provided by the automatic-adjustment provisions will undesirably narrow the responsibility of the private sector in the economic security field. Moreover, it should be realized that increasing the base insofar as it relates to employees and the self-employed does not provide any significant additional financing over the long range, because the additional taxes collected are very closely offset by the additional benefit liabilities created.

VI. CHANGE IN TEST FOR DEPENDENT BENEFICIARIES

This proposal would provide that spouse's benefits (both before and after the death of the worker) would be available only for whichever spouse had had the lower income in the 3-year period preceding retirement, disability, or death.

We support this change, which is both innovative and reasonable. In fact, we believe that further action in this area might be considered at this time, to prevent the windfall benefits which now occur for spouses who do not qualify for Social Security benefits on the basis of their own earnings and who have pensions as governmental employees. The 1974–75 Advisory Council on Social Security made an excellent recommendation in this respect—namely that such government-employee pensions should be considered as an offset against spouse's benefits under Social Security. This is exactly the same treatment that is now accorded to an individual's primary Social Security benefit based on his or her own earnings record, which is offset against his or her spouse's benefit under the Social Security program.

VII. CORRECTING INFLATION OVERADJUSTMENT IN INITIAL COMPUTATION OF BENEFITS

This proposal would correct the technical flaw in the law with regard to the initial computation of benefits. Specifically, this correction would be made by the procedure commonly referred to as "decoupling" through the process of indexing the earnings record by wage trends. The administration did not give any specifics as to its decoupling proposal, although the intent would be to produce replacement ratios in the future that would be at about the same level as for those currently retiring. The Administration also indicated that the transitional provision, which provides benefit amounts at least equal to the present-law formula on the changeover date, would apply only to retirement cases, and not to disability or young-survivor benefits.

We are strongly in favor of the general principle of decoupling by the wage-indexing approach, but we believe that the ultimate level of the replacement ratios should be about 10 percent lower relatively than those currently emerging and, instead, should be at about the level prevailing before 1972. Our belief is based on the facts that the benefit level was over-expanded in 1969–72 (which, incidentally, was an important cause of the present short-range financing problems) and also that there has been a continuing lag in instituting the decoupling procedure.

Our decoupling approach would decrease even more the long-range deficit of the Social Security system and thus come much closer to restoring its financial integrity. We also propose a permanent savings clause for retirement benefits that would utilize the benefit formula under present law as that formula would stand just before the new decoupling procedure would go into effect if it produces a larger amount. Thus, there would be a gradual phasing-in to the benefit level that we recommend, with the safeguard that retirees would, upon retirement, never receive a smaller amount than would be provided under the benefit formula in the present law frozen as of the effective date of the new decoupling procedure.

We strongly support the Administration's proposal that the savings clause or transitional provision apply only to retirement cases, and not to disability or young survivor benefits. This will go a long way toward eliminating the anomalous situation in present law whereby, in such cases, the benefits payable exceed the net take-home pay of the insured worker. Consideration should also be given to imposing a percentage-of-prior-earnings cap on the benefits of disabled workers and their dependents. The Health Insurance Association of America, which has great interest in this area, also holds these views.

We should also continue unchanged the present procedures for adjusting automatically benefits for those on the rolls to reflect increases in the cost of living. Accordingly, all beneficiaries would have not only the dollar amount of their benefits safeguarded, but also the purchasing power of the benefits.

The specific benefit formula that we recommend in connection with the decoupling bill of the Ford Administration last year was based on it becoming first effective in 1978. We still would like to see such an effective date. Of course, if the effective date were to be later, appropriate changes would be necessary. Also, there were a number of essentially technical changes that we would have liked to have seen in the Ford Administration bill, and it may well be that, when the Carter Administration bill is available, we will have some technical comments.

VIII. ADVANCING PLANNED INCREASE IN TAX RATE FROM 2011 TO 1985 AND 1990

This proposal would move ahead the 1 percent increase in the tax rate on both employers and employees now scheduled for 2011, so that one-quarter of it would occur in 1985, and the remainder would occur in 1990.

We believe that the only proper way to obtain additional financing for the Social Security program—other than through reducing benefit costs where these are now irrationally high and overly liberal, or where they provide undue windfalls—is through the clearly visible method of increasing the tax rates. In other words, we are opposed to injecting a government subsidy or to increasing the maximum taxable earnings base more than the automatic-adjustment provisions will do. Accordingly, we support the general principle of this proposed change of increasing the tax rates, although we would go further by instituting increases at an earlier date than 1985—in fact, as early as 1978 or, at the latest, 1979.

In summary, the American Council of Life Insurance believes that the solution to the financing problems of the Social Security program can be achieved by three types of changes:

(1) Decouple the computation of initial benefit amounts at a 10 percent lower ultimate level (with appropriate phasing-in through a permanent savings clause based on the present formula frozen);

(2) Provide any additional financing required through forthright, visible increases in the tax rates (after changing the self-employed basis back to 1½ times the employee rate, as it was initially);

(3) Eliminate certain benefit windfalls, as the Administration would do for dependents' benefits.

Next, let me set forth the cost effects of our proposals over both the short range and the long range. For the OASDI system combined, for the 5-year period 1978–82, the additional income (including the additional interest earnings of the trust fund) is estimated at $66.3 billion, while the lessened outgo is estimated at $10.5 billion. Thus, the net result is an increase in the trust-fund balances of $76.8 billion over what would occur if present law were left unchanged. As a result, the trust-fund balance at the end of 1982 would be $62.0 billion, instead of in a deficit position of $14.8 billion. The breakdown of these figures is shown in Table 1.

Then, as to the medium-range financial situation—the next 25 years—our proposals are estimated to result in an average excess of annual income over disbursements averaging 0.4 percent of taxable payroll. As a result, the system would have adequate financial resources to meet anticipated disbursements for this 25-year period and to build up the trust-fund balances. Table 2 presents the details of this situation.

Finally, as to the long-range financial situation, our proposals would result in reducing the estimated average deficiency for the 75-year period beginning 1977 from 8.2 percent of taxable payroll to only 1.2 percent. Recognizing the difficulties of forecasting precisely for such periods and the variations possible as a result of, for example, birth rates and retirement rates, this is a reasonably satisfactory situation, and the deficiency then is in more reasonably manageable proportions.

I would like now to take the liberty of commenting on a bill now pending before the House of Representatives—namely, H. R. 3363. This bill would remedy a longstanding inequity in the collection of duplicate taxes under the Social Security program and under the Unemployment Insurance program for certain concurrent employers of the same employee. Under such circumstances, the employee is really in effect in only one job, and it seems only fair that the concurrent employers together should not pay on more than the maximum taxable wage base. Such treatment has, for many years, been accorded to successor corporations under section 3121(a)(1) of the International Revenue Code and to state agencies or state-paid employees of political subdivisions under section 218(e)(2) of the Social Security Act. We strongly urge legislative enactment of the provisions contained in H. R. 3363.

In closing, I should like to reiterate the strong support of the American Council of Life Insurance for our Nation's Social Security program. We believe that it should provide an adequate, viable, and sound floor of protection in the economic security area of retirement, long-term disability, and death of the breadwinner. The time-tested method of financing Social Security on a self-supporting basis, without a government subsidy and with a maximum taxable earnings base consistent with those prevailing in the last quarter century, should be continued.

We urge that action should be taken this year to strengthen the fiscal integrity of the Social Security system by rationalizing the benefit structure through decoupling the benefit computation for new claimants under the wage-indexing approach. We also urge that other suitable action should be taken to strengthen the financing of the system, especially in the short range, by an immediate moderate increase in the employer-employee tax rates. The restoration of public confidence in the Social Security program requires no less.

TABLE 1.—SOURCE OF ADDITIONAL REVENUES PRODUCED BY AMERICAN COUNCIL OF LIFE INSURANCE PROPOSALS

[Amounts in billions]

Year	Change in trust funds, present law	Increasing self-employment tax rate [1]	Increasing employer-employee tax rate [2]	Reduced benefit outgo [3]	Additional interest income	Total effect of proposal	Change in trust funds, proposal
1978	−$6.9	$0.1	$8.8	$0.1	$0.3	$9.3	$2.4
1979	−7.9	.3	9.8	.4	1.1	11.6	3.7
1980	−9.1	.3	10.8	1.7	2.0	14.8	5.7
1981	−11.5	.4	11.8	3.2	3.1	18.5	7.0
1982	−14.9	.4	12.8	5.1	4.3	22.6	7.7
1978–82	−50.3	1.5	54.0	10.5	10.8	76.8	26.5

[1] Effect of increasing self-employment tax rate to 1½ times employee rate of 4.95 percent.
[2] Including effect of corresponding higher self-employment tax rate when employer and employee rates are increased by ½ percent.
[3] Effect of decoupling and of new dependency test for auxiliary benefits.

TABLE 2.—*Effect of proposals of American Council of Life Insurance on longer run deficits*

[In percentage of taxable payroll]

Item	*Cost effect*
Effect on average 25-year deficit (1977–2001):	
Deficit under present law	—2.3
Effect of higher tax rates [1]	+1.5
Effect of reduced benefit outgo [2]	+1.2
Resulting actuarial balance	+.4
Effect on average 75-year deficit (1977–2051):	
Deficit under present law	—8.2
Effect of higher tax rates [1]	+1.5
Effect of reduced benefit outgo [2]	+5.5
Resulting actuarial balance	—1.2

[1] Effect of increasing self-employment tax rate to 1½ times employee rate and of increasing employer and employee rates by ½-percent each in 1978 and ¼-percent each in 1985.

[2] Effect of decoupling and of new dependency test for auxiliary benefits.

RECOMMENDED MINOR POLICY CHANGES AND LEGISLATIVE DRAFTING POINTS WITH REGARD TO S. 1902

(By Robert J. Myers, Social Security Adviser, American Council of Life Insurance)

1. INDEXING YEAR RELATED TO INITIAL YEAR OF BENEFITS

Under the bill, wages are indexed to the second year before death, disability, entitlement to old-age benefits, or attainment of age 72 (whichever first occurs)—see page 21, lines 20 and after. The use of "the second preceding year" was believed necessary bcause of the change from quarterly to annual reporting of wages. This results in lower Average Indexed Monthly Earnings (AIME) than if the indexing were, preferably, done to the immediately preceding year. This is compensated for in the bill by higher benefit factors in the Primary Insurance Amount (PIA) formula (which are apparently based on the arbitrary assumption that wages will always increase at an annual rate of about 6 percent) than would otherwise be necessary.

Alternatively, indexing could preferably be done up to "the preceding year" if the aggregate average wage for the second preceding year were increased by, say, the average percentage increase in wages in the three preceding years for which data were available, so as to yild a reasonable estimate for such "preceding year". If this is done, the percentage benefit factors would be 6 percent lower relatively, but this would be approximately counterbalanced by the AIME being larger.

2. INDEXING YEAR FOR RETIREMENT CASES

Under the bill (page 21, lines 21–24), the use of "year of entitlement" to determine the indexing year for retirement cases differs significantly from the use of "the year of attainment of age 62 or, if later, the year of the effective date". as I would propose. In my opinion, the approach in the bill is a serious error.

In the past, under the Social Security program, changes were made from a "year of entitlement" basis to a straight "year of attainment" basis so as to avoid the difficult problems of choosing when to file and become entitled. As the bill now stands, quite different treatment can result for two persons with identical characteristics if one makes a mistake and files his claim too soon (e.g., in December instead of January).

In summary then, the "year of entitlement" basis, as against the year of attainment basis, is inequitable to beneficiaries as between those who are well-informed and cognizant of the intricacies of the law and others (who may well make serious mistakes) and is difficult of administration (because the

SSA offices cannot give proper advice to prospective claimants). Accordingly, benefits for retirement cases should be based on the year of attaining age 62 or, if later, 1979 (i.e., the indexing year should be the year of attaining 61 or, if later, 1978).

3. PAST DATA TO BE USED FOR INDEXING THE EARNINGS RECORD

The bill does not make it clear what annual wage data for past years will be used for indexing purposes (page 22, lines 3–6). It is stated that such data are to be used on total wages in all employment, and not merely on taxable wages in covered employment. However, such data do not exist, except on an estimated basis (which estimates may or may not be very accurate). The bill should make it clear as to what past data will be used and where they will be obtained.

4. ROUNDING OF EARNINGS BANDS IN PRIMARY BENEFIT FORMULA

The benefit formula in the bill is adjusted from year to year by changing the dollar amounts of the earnings bands in accordance with changes in annual wages of all employees in the country (whether or not covered). The results are rounded to the nearest $5. See page 13 for these provisions.

Rounding should, instead, be to the nearest $1. Otherwise, there are too sharp breaks in the results from the formula from one year to the next, which is particularly important if individuals can manipulate which year's formula is applicable to them—as is possible under the bill.

5. ROUNDING OFB EARNINGS BAND IN MAXIMUM FAMILY BENEFIT FORMULA

As in the case of the formula for primary benefits, when the formula for Maximum Family Benefits under the bill is changed from year to year, the earnings bands are rounded to the nearest $5 (page 33, lines 3 and after). This creates problems of equity. This occurs because the PIA increases with the CPI, and the MFB increases due to changes in wages affecting the dollar bands in the MFB formula, so that a "coupling problem" occurs. The solution is to make future changes in the initially determined MFB (or the MFB resulting from a recomputation of the PIA) in accordance with CPI changes.

6. INITIAL LEVEL OF MINIMUM PIA

The bill is technically deficient (page 14, lines 13), because it assumes that the present minimum PIA of $114.30 will be increased to $120.60 for June 1978, a 5.5 percent rise (as estimated in the 1977 Trustees Report). This may or may not eventuate. The solution to this technical deficiency is to refer to "the minimum amount that will be applicable for June 1977", rather than to cite a specific figure, which at this time can only be an estimate.

7. AMOUNTS OF MAXIMUM FAMILY BENEFITS

The bill would (except as noted later) closely duplicate the results and relationships under present law for 1979 cases, if the 1978 benefit increase is 5.5 percent (see page 32, lines 5 and after). The bill appears to be technically in error at the upper portion of the earnings range. The result is that, for PIAs of $345 or more in 1979, the MFB is lower than under present-law procedures in all cases, if the 1977 benefit increase is 5.5 percent. This could, and should, be avoided by having the 275 percent factor apply to a band of $110 of PIA (instead of $95), and then the 130 percent factor apply to a band of $100 of PIA (instead of $115), and finally the 175 percent factor apply to the PIA in excess of $455 (as in the bill).

8. BENEFIT COMPUTATIONS UNDER PRESENT-LAW METHOD

Under the bill, the present-law method (frozen at the December 1978 basis) would only be applicable for initial retirement benefit computations, and then only for individuals who are first eligible for benefits before 1984 (page 18), line 21 and after). This procedure seems inequitable with respect to the first recomputation, when it is based on earnings in the year of retirement. For example, a person retiring in December 1979 might be well advised to wait until January 1980 to file and become entitled, because then he could use the present-law method applied to earnings up through 1979. On the other hand,

for filing in December 1979, the earnings in 1979 could not be considered under this method. Accordingly, it would seem more equitable to permit the use of both benefit computation methods for all recomputations, or at least for a recomputation involving earnings in the year of retirement.

Also, the old-start method of computing benefits (going back to 1937) is changed from the present simplified method to a much more complex one based on differences by when age 21 was attained and how many increment years are to be credited (page 24, lines 4 and after). There seems to be no good reason why this change is made, and it may make for differences in treatment as between persons becoming entitled before and after enactment. It is also not clear why this possibility is limited only to persons attaining age 21 in 1937–50 (i.e., age 62 in 1978–91); this seems inequitable and inconsistent.

The bill would provide considerably different treatment as to computation of retirement benefit amounts for persons eligible before 1979 (i.e., generally who had attained age 62 before 1979) than for those who become eligible after 1978 (page 19, lines 16 and after). The latter can use the new indexed method and, if eligible before 1984, the frozen present new-start formula (or, strangely enough, the old-start method regardless of when eligible, even if after 1983). Those eligible before 1979 can never use the new indexed method, but rather use the present new-start formula not frozen, but rather going on in the present coupled basis for all future years (it is not clear how, if at all, the old-start formula is used for this category). The result is certainly an undue discrimination between the two generation groups—it is not clear which way the discrimination goes or who it favors. There should be identical treatment for these two categories, so that both can use both the old formula frozen and the new indexed method.

9. PIA BENEFIT FORMULA

If one accepts the underlying philosophy of the bill that the replacement levels should be stabilized over time at the level that would arise under present law in 1979, the benefit formula (page 12, lines 20 and following) is wrong because it undesirably (from a social-benefits standpoint) results in replacement rates for the highest earners that rise over time. The formula applicable in 1979 should be changed so that the second breaking point (page 13, line 12) is changed from $1,075 to $985 and so that the percentage applicable to the highest band of earnings (page 13, line 4) is 10 percent, rather than 16 percent (note that the 16 percent figure is not based on any actual current-experience data). Thus, the 1979 formula would be 94 percent of the first $180 of AIME, plus 34 percent of the next $805 of AIME, plus 10 percent of the AIME in excess of $985. This, in conjunction with the savings clause, would stabilize replacement rates for the highest-earnings persons, instead of allowing them to rise. Such a change would have a favorable effect on the long-range financing problems, because it would result in lower costs.

I should point out that my recommended formula for 1979 is 82 percent of the first $190 of AIME, plus 30 percent of the next $760 of AIME, plus 10 percent of AIME in excess of $950. This will produce stable replacement ratios over time (after being gradually phased into) at about a 10 percent lower level than presently deevloping ratios emerging under present law and *at all earnings levels.*

10. DRAFTING ERRORS

(*a*) Page 3, lines 12–15. This language gives erroneous mathematical results, because "one-term" means "rounded to nearest whole percent" and because the divisor should not be 1,000 if base percentag eis "6". It should read "(B) 3 times the excess of (i) the average rate of unemployment expressed as a number of percentage points reduced to the nearest 0.1 percent over (ii) 6.0, divided by 100".

(*b*) Page 4, lines 8–10. The dates of appropriation of the "payment for high unemployment" are too imprecise by being open-ended (e.g., "no later than June 30, 1979" could be as early as the day after enactment!).

(*c*) Page 6, line 5. The reference to "Paragraphs (1) and (2)" should be to "Paragraphs (1) through (6)". The same comment applies to line 9 on page 7.

(*d*) Page 6, lines 22–23. The reference to "Paragraphs (2) through (4)" should be changed (also in line 25 on page 7 and continuing to page 8).

(*e*) Page 12, line 7. A comma should be inserted after "OLD-AGE".

(*f*) Page 14, line 14. "subparagraph" should be "subsection".

(*g*) Page 31, line 3. "(I)" should be deleted.

(*h*) Page 17, line 14. "that" should be "such a".

(*i*) Page 19, lines 4 and 5. These should be a new sentence in Paragraph (4), and thus flush with the left margin and should read "In making the comparison required by subparagraph (A)—". Also then, in line 15 on page 18, delete "(i)".

(*j*) Page 23, line 5. Unlike present law, the year of death will not be able to be used as a benefit computation year if it is a year of high earnings unless "or died" is changed.

(*k*) Page 24. In line 19, "credit" should be "credited". The language in lines 17–18, beginning with "and the remainder" does not give the intended mathematical result; it should read "and the excess of the individual's total wages prior to 1951 over the total so deemed for the years in the divisor".

(*l*) Page 25, lines 1–2. The words "as provided by clause (I)" lead to an incorrect result (by assigning such deemed wages for a fractional increment of $3,000 to the year immediately preceding the earliest year used in the divisor. Instead, these lines should read "less than $3,000 credited to the year prior to the earliest year to which a full $3,000 increment was credited; and". Also, mention should be made that no wages should, under any circumstances, be credited for years before 1937.

(*m*) Pages 31, line 25. The first comma should be deleted.

Senator NELSON. Our final witness this morning is Mr. Jack E. Bobo, president-elect of the National Association of Life Underwriters and chairman of the NALU Federal Legislation and Law Committee.

If you would identify your associate for the reporter, you may proceed.

STATEMENT OF JACK E. BOBO, PRESIDENT-ELECT OF THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS AND CHAIRMAN OF NALU FEDERAL LEGISLATION AND LAW COMMITTEE, ACCOMPANIED BY MICHAEL KERLEY, COUNSEL FOR SOCIAL SECURITY MATTERS

Mr. BOBO. Thank you, Mr. Chairman.

My name is Jack Bobo. I am a full-time life underwriter working in Phoenix, Ariz. I appear here as president-elect of the National Association of Life Underwriters, and I would like to speak on its behalf.

I am accompanied today by one of the members of our Washington staff, Mr. Michael Kerley, who is our counsel for social security matters.

I would like to summarize the sense of our statement, which has been filed for the record, but first I would like to distinguish between our organization and the company organization which has just testified.

We represent the agents, general agents and managers in the country who market and sell life insurance products in all the cities and towns in the United States. In that capacity, we do not speak for the company interests.

I believe that it would be helpful for the committee, Mr. Chairman, if I could just take a moment to preface our statement with respect to the perspective with which we view the problems of social security in order that you could properly understand the context of which we speak.

The National Association of Life Underwriters and its members represent the largest single group of people who regularly talk to the public about social security benefits with the possible exception of

the employees of the Social Security Administration. We do this on a one-to-one basis.

There is one important distinction between the people who our members talk to, however, and those with whom the Social Security Administration talks. In a sense, we are talking to the future beneficiaries, the current taxpayers, where they are primarily dealing with the current beneficiaries.

We speak to the public about social security benefits at a time when we are programming their survivors' benefits—coordinating retirement plans they've started on their own initiative and also those that might be provided by the employer.

We believe that over the years, the members of our association have contributed greatly to public understanding of the social security system, and have been largely responsible for the tolerance to the high level of taxation that has been necessitated by the payments of benefits.

With respect to our current position, it closely parallels our historical position in the sense that we have always felt that the system should be financed on a pay-as-you go basis through the payroll tax, and we currently, today, feel that that would be the best solution to the short-range financing problems.

So we would advocate an increase in the payroll tax to be equally shared by the employee and the employer. In making this recommendation, we are mindful of the opposition that has been put forth to this proposal. We would still contend that this is the only visible mechanism by which the public can identify what they are paying with the potential benefits that they are likely to derive. And, we feel that this is very necessary, the visibility, for several very important reasons, not the least of which is to help to curb the public's appetite for benefits and thereby ease the pressure on Congress for unreasonable demands to expand the system.

We also feel that, at this particular time, this visibility is needed very badly. We have an environment, today, where best-selling books refer to social security as a "felony fund" and certain economists draw an analogy between the social security system and a chain letter system.

We think whatever solution comes forth at this time has to be highly visible and very credible. We have not, of course, participated in these extravagances and have attempted to disseminate information of a more positive nature, but we are particularly sensitive to one criticism of the payroll tax increase, and that is that the tax, taken by itself, could be construed as being regressive. We have, of course, always held that the system, when viewed as a whole, perhaps is not regressive, but increasingly, as the wage base has increased, and the taxes have increased, this is a concern about which we have to be a little more responsive.

So for that reason, on page 6 of our testimony, we would like to propose for consideration of Congress, a graded tax increase on the employees contribution rather than the level increase that has been proposed by most other persons.

In this proposal, we would envision that there would be no tax increase on the low wage earner, say, the first $4,000 of income, and then the balance of the increase would be graded within the tax base up to the wage base maximum.

If this proposal were adopted, the very low wage earner would actually receive no increase in taxes at this time, and the maximum at the upper level would be 0.55 percent for the employee at the very top of the wage scale. In dollars and cents, this would entail an increase of zero for the low wage earner and a maximum of only $91 at the top of the scale.

Senator NELSON. I am looking at this 0.42 of 1 percent as a maximum—what is the maximum increase?

Mr. BOBO. The average percentage tax rate would rise from 5.5 to 6.4 percent for the top wage earner, which would amount to a payment of $1,056 instead of the $965 which he is currently paying, so that the total maximum increase would be $91 at the very highest point in the wage base.

Senator NELSON. Have you computed what that would raise?

Mr. BOBO. Yes, sir.

Our studies would indicate if the employer's portion of the tax were raised proportionately on a level basis, because the regressive argument does not apply there, the total amount of the wage would be 1 percent and would be an amount which we feel would be necessary to take care of the current problems of the financing.

In other words, what we are recommending is a total increase of 1 percent, but rather than make it level with the employee, it would be graded to deal with the argument that the tax itself is regressive.

Senator NELSON. Did you compute what it would be when it is applied against $21,000?

Mr. BOBO. We did not take it beyond the current level. We would be delighted to provide that to the committee, if you so desire.

[The following was subsequently supplied for the record:]

EMPLOYEE TAX AND AVERAGE PERCENTAGE RATE TAX FOR 1978 UNDER NALU GRADUATED TAX PROPOSAL ASSUMING $21,000 MAXIMUM TAXABLE EARNINGS BASE AND AN INCREASE IN OASDI TAX RATE SUFFICIENT TO PROVIDE TOTAL ADDITIONAL FINANCING EQUIVALENT TO 1 PERCENT OF TAXABLE PAYROLL[1]

Annual wage	Employee tax	Average percentage tax rate
$1,000	$60.50	6.05
$2,000	121.00	6.05
$3,000	181.50	6.05
$4,000	242.00	6.05
$5,000	302.50	6.05
$6,000	368.70	6.14
$7,000	434.90	6.21
$8,000	501.10	6.26
$9,000	567.30	6.30
$10,000	633.50	6.34
$11,000	699.70	6.36
$12,000	765.90	6.38
$13,000	832.10	6.40
$14,000	898.30	6.42
$15,000	964.50	6.43
$16,000	1,028.80	6.43
$17,000	1,093.10	6.43
$18,000	1,157.40	6.43
$19,000	1,221.70	6.43
$20,000	1,286.00	6.43
$21,000	1,350.30	6.43

[1] An increase in the base from the $17,700 that would result under present law to $21,000 would provide equivalent effective long-range savings averaging 0.3 percent of taxable payroll. Therefore, the necessary increase in the OASDI combined employer-employee tax rate would be 0.7 percent if the employer and employee contribute as under present law. The equivalent of this 0.7 percent under the NALU proposal would require an increase in the employer rate presently scheduled for 1978; namely, 6.05 percent (4.95 percent for OASDI and 1.1 percent for HI), amounting to 0.38 percent (i.e., 55 percent of 0.7 percent) producing a rate of 6.43 percent. The tax schedule for the employee corresponding to this would be: 6.05 percent on the 1st $5,000; 6.62 percent on $5,000 to $15,000 (i.e., 6.05 percent, plus 82½ percent of 0.7 percent); and 6.43 percent on $15,000 to $21,000 (i.e., 6.05 percent, plus 55 percent of 0.7 percent). For explanation of the procedure involved in determining the tax rates under the NALU proposal, see my memorandum of July 15, 1977, entitled "Proposal To Have Graduated OASDI Tax Rate To Provide Additional Financing."

Proposal To Have Graduated OASDI Tax Rate To Provide Additional Financing

(By Robert J. Myers)

This memorandum supplements my memorandum of May 5 on the above subject in order to describe how the proposal would operate when the taxable earnings base is increased from the present $16,500 (on which basis the proposal was developed) or when a further increase in the tax rate is made in the future.

The previous memorandum indicated that, if it were desired to obtain a total employer-employee average rate which is 1 percent of payroll higher, the tax rate schedule for the employee (on a retrospective or refund basis) would, for 1977 for OASDI and HI combined, be 5.85 percent on the first $4,000, 6.675 percent on $4,000 to $12,000, and 6.40 percent on $12,000 to $16,500. The employer rate (as well as the initial withholding for the employee) would be a uniform 6.40 percent.

Various possible alternatives exist as to how to make changes in the tax schedule for future years. In my view, the best and simplest method as to when the earnings base increases before there is another change in the OASDI tax rate from that under the proposal is as follows:

(1) Establish the first band at 25 percent of the maximum taxable earnings base, rounded to the nearest $1,000 (i.e., the $4,000 upper limit would be retained until the base reaches $18,000).

(2) Determine the upper limit of the second band (which is, of course, also the lower limit of the highest band) at three times the upper limit of the first band.

When there is an increase in the OASDI rate in the future, the procedure for 1981), such increase would merely be added uniformly to the rates for all three bands. Thus, for 1978, the proposed rate schedule would be: 6.05 percent on the first $4,000; 6.875 percent on $4,000 to $12,000; and 6.60 percent on $12,000 to $17,700 (as against a uniform 6.05 percent on $17,700 under present law).

When there is an increase in theOASDI rate in the future, the procedure would be as follows for the employee net rate:

(1) The rate for the lowest band of wages would be retained at 5.85 percent.

(2) The rate for the middle band of wages would be increased by 82½ percent of the increase that is desired in the total employer-employee average rate.

(3) The rate for the highest band of wages would be increased by 55 percent of the increase that is desired in the total employer-employee average rate.

As an example of how the foregoing suggested procedures would operate, let us consider 1985 (when the earnings base under present law is estimated to be $27,900). The earnings bands in the tax schedule for employees will be: under $7,000 (i.e., 25 percent of $27,900); $7,000 to $21,000 (i.e., 3 times $7,000); and $21,000 to $27,900. Let us assume that the OASDI total employer-employee average rate was increased by 1 percent in 1978 (as described in the second paragraph of this memorandum) and that another such rate increase of 0.6 percent is desired for 1985. Let us also assume that the employee HI rate (as well as the employer HI rate) increased by 0.2 percent in 1978 and by 0.25 percent in 1981 (as scheduled in present law). Then, the employee net rate would be as follows:

(1) The rate for the lowest band of wages would be 6.30 percent (5.85 percent, plus 0.2 percent, plus 0.25 percent).

(2) The rate for the middleband of wages would be 7.62 percent (6.675 percent, plus 0.2 percent, plus 0.25 percent, plus 82½ percent of 0.6 percent).

(3) The rate for the highest band of wages would be 7.18 percent (6.40 percent, plus 0.2 percent, plus 0.25 percent, plus 55 percent of 0.6 percent).

It should be kept in mind that the average net employee rate will gradually increase as wages rise for individual cases until levelling off for the highest band (at the rate applicable to that band). This is as shown in the table at the bottom of page 6 of the NALU testimony before the Senate Finance Committee on July 15.

As to the tax rate basis for the self-employed, it will merely be 1½ times whatever the tax is for employees.

Finally, I should address the question as to what would be done for 1978 (or 1979, if action is first taken then) if it is not desired to have an increase of 1 percent in the total employer-employee average rate (possibly because—undesirably in my view—the taxable earnings base is increased more than the automatics will do). Under such circumstances, the general procedure described in the fourth preceding paragraph would be followed. For example, if only an increase of 0.5 percent in the total employer-employee average rate in 1978 is desired, the employee *net* rate would be as follows: 6.05 percent on the first $4,000; 6.4625 percent on $4,000 to $12,000; and 6.325 percent on $12,000 to $17,700. Note that the complex fractional rates would not cause difficulties for individuals because tax tables, rather than tax rate formulas, would be used for the income tax returns on which credits would be claimed.

Mr. Bobo. At any rate, the point that we would like to make, I believe, is that all of the alternate proposals that we are familiar with, such as the raise in the wage base, deriving funds from the general fund, or the development of the separate tax on consumption, like a value-added tax, all of these are nothing more than mechanisms to either directly or indirectly shift the cost of the additional financing from the low wage earner to the high wage earner.

We believe that the graded increase in the payroll tax accomplishes exactly the same thing, except that it is simpler and more forthright. It is visible, and we believe that it would be less expensive to administer than creating a new and separate tax structure.

So we would like to offer this as a consideration to the committee in dealing with the short range problem.

With respect to the wage base, much has already been stated about that today, and I would simply reiterate much of what has already been said. We would oppose raising the wage base as a potential solution because it is nothing more than a temporary expedience, producing cash today, but problems down the road, which we feel would outweigh the advantages to be gained today—not to discount also the fact that this could have a highly disruptive effect, particularly if it were raised significantly, on private pension plans, private savings, and would further discourage private initiative.

We have always opposed the concept of using general funds both on a limited basis and on a more expanded basis because it would be a departure from the traditional method for financing social security. It would tend to associate in the public mind all the other budgetary problems of the country, and we feel that this would accelerate the attacks by critics of the system.

It has often been held that the payroll tax is unfair because low wage earners pay more social security tax than they do income tax. But what is often overlooked is that this is also true of a good many high wage earners, too. They do not pay any Federal income tax either. The idea of financing their benefits from general funds is specious.

So we think that the payroll tax is a much more equitable way of being absolutely certain that everybody pays their fair share. This would be particularly true if this concept were extended to the employer's side of the contribution, because there are a good many employers who, not because of lack of money but because of our tax laws, do not pay Federal income tax. Again, we would support the use of payroll taxes out of a sense of equity.

Moreover, we feel the general fund would be subject to all kinds of budgetary pressure, many of which we could not even conceive at this point. It is an annual decision, and retirement, in particular, requires a lifetime of planning. To subject a person's potential retirement benefits to an annual decision would certainly create anxiety and uncertainty among the public.

With respect to long-range problems, we are in general agreement with most of what has been said this morning. We would favor a decoupling plan that was indexed to wages rather than to prices. We believe that the wages offer a much more stable basis on which to index future benefits, and again, stability is an absolute must in terms of planning for retirement, which is something a person has to do over their entire working life.

Moreover, the indexing plan we support in our statement would reduce replacement ratios more closely parallel to the existing ratios, although the result would be somewhat higher than that produced by prices.

With respect to miscellaneous matters, very quickly, we support the idea of returning the self-employed tax to 1½ times the employee tax. We would oppose also the shift of hospital insurance trust funds into the OASDI for reasons that have already been mentioned by others. But we do believe that the changes in the dependency test for beneficiaries is a constructive step, and we wholeheartedly support that.

I would say, just in closing, Mr. Chairman, that in our experience with personal and corporate planning the most important question about future income is, will it be there? The second most important part is, how much? Our observation of those companies and individuals that have experienced problems in retirement over the years, is generally because those two priorities are reversed, when "how much" is put in place of "will it be there."

It is our firm conviction that any failure to meet this problem head on by an identifiable tax on the payroll is sacrificing the first priority. And so we would again urge that that be addressed in a most forthright way.

Congress, certainly, in the passage of the Pension Reform Act several years ago did so with the hope and expectancy of bringing integrity and stability to the private pension sector, at considerable expense, in many instances, to the private sector. We believe the most important public system certainly deserves the same kind of consideration.

The membership of NALU represents, we feel, the largest positive force for disseminating information to the public about their social security system. And we would like to continue to be able to do that and continue to perform that function with confidence.

It is in that spirit that we offer testimony here today, and we do appreciate the opportunity to do so.

Senator NELSON. Thank you very much for taking the time to come and present your testimony this morning. The committee appreciates it very much.

[The prepared statement of Mr. Bobo follows. Oral testimony continues on p. 358.]

STATEMENT OF THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

(By Jack E. Bobo, CLU)

INTRODUCTION

Mr. Chairman and members of the Committee, my name is Jack E. Bobo. I am a practicing life underwriter in Phoenix, Arizona, but appear today in my capacity as President-Elect of The National Association of Life Underwriters (NALU) and Chairman of its Committee on Federal Law and Legislation.

These hearings have been called to receive testimony on one of the critical issues of our time—the present and future financial condition of the Old-Age, Survivors and Disability Insurance (OASDI) system. NALU thanks the Committee for the opportunity to present its views.

NALU is a Washington based trade association representing approximately 130,000 life and health insurance field sales representatives who do business in virtually every community in the United States. Since the inception of the Social Security program, life underwriters have been a primary source of information for the public on what Social Security means to individuals and families in terms of their financial security.

An analysis of an individual's need for life insurance frequently and logically builds upon the foundation established by Social Security. Through an analytical process designed to establish an individual's financial security needs, a life underwriter explains the very important role that Social Security plays in the lives of almost every American. And, the people to whom life underwriters talk are not usually the individuals who are receiving benefits, but are the persons paying the taxes to finance those benefits. The present generation of workers—the payors, if you will—must thoroughly understand Social Security and support it or its future will be in jeopardy. Life Underwriters have been in the past and are presently a primary source for building this understanding and support.

As an Association, NALU has consistently supported a sound Social Security program based upon the concept that Social Security should provide a basic floor of protection for covered individuals. The basic floor of protection concept, as we view it, means that Social Security should make sure the basic necessities of life will be within the financial reach of average individuals and families covered under the program, leaving to those individuals and families the opportunity, the incentive, and the means to add additional security by their own initiative. NALU has thus always warned against proposals to expand the program beyond this basic floor of protection concept.

It seems clear that a program which provides significantly more than a basic floor of protection would require concomitant funding and thereby run the risk of becoming ever more financially onerous to the segment of the population which is charged with the responsibility of paying for it. NALU believes that the recent rash of magazine and newspaper articles dealing with the future of Social Security foretells a growing awareness on the part of taxpayers as to the alarming portion of their current income that goes to finance Social Security benefits. The taxpayers are concerned, and, unless the present law is changed, Social Security will require even larger proportionate amounts of worker's income in the future. As NALU has said many times before, Social Security is not a "magical machine" into which one can constantly put $1 in taxes and expect to get $10 in benefits out the other end.

We believe that now is the time to bring the system back to financial stability. While this step may be difficult, it must be taken. Too much time has already been wasted in the vain hope that the problem will rectify itself. The fact is that the trust funds from which retirement, survivor, and disability benefits are paid are running out of money. We have already delayed to the point where there is some question whether corrective measures can take meaningful effect before the Disability Insurance Trust Fund is depleted. Congress should act before the end of this Session.

The nature of the short term financial problems besetting Social Security and the prospects of even more severe problems in the future have been ably explored and documented by the various experts who have already appeared before this Committee. It is really not necessary to go over this ground again and so we will not attempt to do so here. In the balance of this statement,

therefore, NALU will present its ideas on how these short and long term problems might be solved without tearing apart the fabric of the Social Security program—or bankrupting the Nation.

In presenting NALU's point of view, we will also comment on some of the other proposals put forward to shore up the system, most notably the package assembled by the Administration.

TAX RATE INCREASE

Taken on balance, the Carter Administration Social Security proposal is a comprehensive approach to dealing with serious and vexing problems. The plan's overall goal cannot be faulted nor its intentions questioned. NALU does question, though, the lack of inclusion in this package of the one element which is guaranteed to contribute toward solving the immediate problems without creating new ones down the road. This element is an increase in the tax rate.

Historically, the Social Security tax has been the revenue raising mechanism for the Social Security system. Contrary to popular belief, that function has not been fulfilled by the tax base, it being reserved to determine the size of benefits as a percentage of wages. Unfortunately, some proposals have been put forward which confuse the purpose of the wage base, using it as a revenue raising tool. Such proposals we believe are ill advised.

The point most often raised against a tax rate increase is that the Social Security tax is regressive, and an increase in it will only make it more so. It is quite true that the FICA tax is regressive, in that lower paid workers pay a proportionately larger share of their overall earnings for this purpose than the highest paid workers. But this argument completely overlooks the offsetting side of the equation, that is, that benefits are highly progressive, so much so that in the overall picture lower paid workers receive by far the better deal than higher paid workers. They stand to receive much more in benefits than they paid for them.

Another aspect of the regressivity argument is that many workers pay more in Social Security taxes than they do in federal income taxes. What usually the reason for this is that many workers pay higher Social Security taxes than they do income taxes because deductions, exemptions, etc. reduce their federal income tax bite. And, it is true for another reason which is not often stated: many workers, even highly paid workers, pay no income tax at all.

The point here is that the best way to guarantee that everyone who will eventually receive benefits pays toward the financing of those benefits is to raise the revenues through a payroll tax. Any non-payroll source, such as general revenues, increases the risk that some individuals who will later receive benefits will not pay their fair share into the system. All things considered, NALU recommends that the payroll tax remain as the essential financing tool of Social Security, and that a tax rate increase be instituted.

NALU recommends an increase of 0.5 percent each in the FICA tax rate levied on employers and employees to become effective in January 1978. Actuarial data available to NALU indicates that this is the size of a rate increase which is needed to stop the net outflow of funds from the OASDI Trust funds. Our figures indicate that the recommendations of the Ford Administration last year were too low at that time to accomplish the desired effect, and unfortunately those recommendations at this late date are even less able of doing the job.

A rate increase has an advantage in addition to being the most effective means of raising revenue. The payroll tax is accurately perceived by workers for what it is, the money they pay to guarantee their own benefits when the time comes. In this respect it is the most visible financing tool available, and as such helps put a brake on undue expansion of the Social Security system. The public needs to have a clear understanding of the cost of benefits if it is to make sound judgments about the proper role for Social Security. The payroll tax makes an appreciation of the cost of the program difficult to avoid.

GRADUATED SOCIAL SECURITY TAX

The regressive nature of the Social Security tax cannot be ignored, however. Since the members of NALU talk primarily with the Social Security taxpayers rather than Social Security beneficiaries, we can assure the Subcommittee that

concern about the size of present Social Security taxes is widespread. Taxpayers want their tax burden reduced, but not just their Social Security tax. Taxes of all kinds meet with growing negative sentiment. In the case of Social Security taxes, though, there is at least the expectations of a return some day, distant though it may be. Therefore, we believe that most workers will tolerate more in the way of Social Security tax increases than other taxes on which no direct return is perceived.

As an alternative to a straight across the board increase in the Social Security tax rate, the Committee may wish to consider instituting a progressively graduated tax rate increase which would be applied to the earnings of employees within the wage base. The basic premise of this proposal would be to tax lower paid workers at the current level, and gradually increase the rate applied to middle and higher paid workers.

The possible choices for a progressive tax are probably unlimited although the schedule chosen must add up to an average increase of 0.5% on employers and employees in order to achieve the financing required to bring the Trust funds back into balance. NALU suggests the following schedule to achieve that result:

EMPLOYEE SOCIAL SECURITY TAXES UNDER GRADUATED PROPOSAL AS IT WOULD HAVE APPLIED IN 1977

Annual wage	Employee tax	Average percentage tax rate
$1,000	$58.50	5.85
$2,000	117.00	5.85
$3,000	175.50	5.85
$4,000	234.00	5.85
$5,000	300.75	6.02
$6,000	367.50	6.13
$7,000	434.25	6.20
$8,000	501.00	6.26
$9,000	567.75	6.31
$10,000	634.50	6.35
$11,000	701.25	6.38
$12,000	768.00	6.40
$13,000	832.00	6.40
$14,000	896.00	6.40
$15,000	960.00	6.40
$16,000	1,024.00	6.40
$16,500	1,056.00	6.40

The result of this proposal would be to produce the same total tax income from employers and employees as a uniform increase of 0.5 percent each. Employees would pay 5.85 percent on the first $4,000, 6.675 percent on the next $8,000, and 6.40 percent on $12,000 and over. Those earning under $4,000 would pay the same rate as now, those earning over $12,000 would pay an increased rate of 0.55 percent, and those earning between $4,000 and $12,000 would pay an average increased rate of less than 0.55 percent. The employer tax rate under this proposal would be a uniform 6.40 percent.

In all likelihood the only way that this proposal could be administered would be on a retrospective or refund basis. The tax rate would have to be increased for payroll deduction purposes for employees, by the determined uniform ultimate amount (0.55 percent for the schedule discussed above). Then, those who, after the taxable year has ended, had earned less than $12,000 would be entitled to a refund of the excess OASDI tax paid, just as is now the case for those who, due to employment with more than one employer, have paid Social Security taxes on more than the maximum taxable earnings base.

One advantage of this proposal is that it would answer critics of the tax-rate increase method who express concern about the effect such increases will have on lower paid persons, and also decry a lack of progressivity in OASDI taxes. An obvious disadvantage of a progressive system is greater complexity.

ADJUSTMENTS IN WAGE BASE

In recommending either across the board tax rate increases or a substitute progressive tax rate schedule, we reject expansion of the wage base as a short or long term solution to Social Security's financing deficits. NALU's objection

to financing benefits via the wage base rests on the precept that the tax base was never intended to be the revenue raising mechanism for the system; neither is it a very efficient means of doing so. Rather, the wage base was intended to delimit the extent of benefits to those workers within the system. And, over the years, the equalization of the wage base between employers and employees was intended to underscore the principle that employers and employees are both responsible to the same extent for the financing of the system.

As the system evolved during its formative years, it also became clear that the size of the wage base in relation to total payroll played a significant role in establishing how much the employee and employer could do for themselves in establishing economic security for workers. The higher the wage base goes, the higher the benefits and taxes go, and less net income remains for private investment or savings as employers and employees see fit.

The Carter Administration package proposes to break with tradition by eliminating the wage base on employers entirely, and adjusting it upward for employees over a period of years by a total of $2,400 above what the automatic adjustment mechanisms would produce. The elimination of the employer wage base ceiling would result in a net inflow of funds to the system because, presumably, the elimination of the employer wage base would not result in the payment of larger benefits to workers at a later date. Thus this scheme escapes the criticisms that it only creates more liability down the road.

Not so with the increase in the employee base. Here the increase will result in higher benefits at a future date and will offset, at least partially, if not wholly, the gains to be made in the initial years. This has traditionally been one of the arguments against using the wage base as a financing mechanism. The short term gains are offset in part by long term inreases in liabilities to the system, and in the final analysis such increases only expand the system more, to the detriment of the private sector.

NALU's concern with the Administration's wage base proposals is that they will have a deleterious effect on the private insurance sector. Of course, the insurance industry will not stand alone in adverse effect. Presumably, securities, banking, and thrift markets will also be affected seriously, as each represents a traditional place where workers save what they can for their own financial security.

We believe, however, that the private pension system would face the most severe competition from Social Security because of increases in the employer Social Security tax costs. There is only so much money available for utilization in employer-sponsored pension programs, and our great fear is that employers will ultimately have to make a choice as to whether to fund pension programs for employees or pay Social Security taxes to fund the public retirement system. It is difficult to project accurately just how heated the competition for funds will be between private pension programs and Social Security. But, it is difficult to argue that elimination of the employer wage base will not have a profound impact on private pensions.

Wage base increases on the employee side will affect other aspects of the private investment market, most notably individual insurance and savings accounts. Over the last few years our members' experience indicates that workers with incomes at or below the Social Security wage base are becoming increasingly less interested in purchasing insurance or saving money for long term future security. This is occurring for two reasons.

The first involves the calculation of future retirement benefits based on the present coupled system. Replacement ratios are projected to rise to such an extent that, in some cases, workers can expect more benefits in retirement than they earned in wages the year prior to retirement. For many young workers, present disability and survivor benefits would replace more than they bring home today. Under these circumstances there is simply no incentive to invest in one's own economic security. This factor can be eliminated in whole or in part by "decoupling," which will be discussed below.

The second factor mitigating against an individual taking action on his own is the simple fact that the dollars necessary to do so are competed for by the necessities of life—food, clothing and shelter. Increasing the wage base means increasing the number of people who will leave more of their income with the government and have less of it for their own use. This loss of discretion on the part of workers has an immediate impact on such private sector investments as insurance, but we believe that it has a long term effect on the ability of people to make judgments about their lives.

GENERAL REVENUE FINANCING

Another break with the past is the President's proposal to inject revenue from the general funds into Social Security. Financing of Social Security benefits from general revenues has long been sought by advocates of an expanded system who believe that Social Security should be a three handed program financed by workers, employers and government.

NALU is opposed to general revenue financing, even on the somewhat limited basis proposed by the Administration, because we believe that ultimately the program will be irreparably harmed by general revenue financing. In the early years, general revenue contributions may provide relief from anxiety about the financial stability of Social Security, but we believe that such relief will be short lived.

The pressure from some social planners seems to be for constantly escalating benefits. Countering that pressure, however, is the reality that those benefits must be paid for. At present, we believe that most workers understand who pays for those benefits. They do—through payroll taxes that quite frankly are hurting the pocketbook of many of them.

At first glance, this awareness may seem undesirable, but on closer inspection the reverse may be more appropriate. This is so because the pain in the pocketbook may be the only factor which keeps the benefit/financing system in fairly close balance. In this respect it is analogous to the average family's budget. Generally speaking, families know that they want consumer goods. But, in most cases, their appetite for such goods is tempered by the necessity—and the ability to pay for them.

The introduction of general revenues into Social Security may be similar to infusing money from a rich relative into the family budget. But, in the case of Uncle Sam, the relative is not so rich—in fact he is badly in debt. The illusion created—and it is just that—is that someone else is paying for the benefits. Under these circumstances, it is understandable that pressure would be exerted to increase benefits. One day, however, the apparently rich relative will reach the end of his capacity to borrow money to pass on to his family. Then, benefits will have to be curtailed, or financial disaster will ensue for the entire program.

When this occurs, many Social Security experts believe that it is inevitable that a means test for beneficiaries will become necessary to cut the cost of the program. If a means test were to be adopted, the link between paying Social Security taxes and receiving benefits will be broken in the minds of most workers, and it is doubtful that the system would ever receive the kind of public support it does now. Without widespread worker support, we believe the system would be imperiled.

DECOUPLING

While NALU disagrees strongly with proposals to expand the wage base and shift funds from the general treasury to Social Security, the Association wholeheartedly agrees that the flaws built into the Automatic Adjustment Mechanisms must be corrected as soon as possible. In fact, NALU submitted an actual decoupling bill in testimony before the House Ways and Means Committee in February 1976. Unfortunately, neither the Committee nor the Congress saw fit to adopt decoupling legislation in the last Congress, and so, today, Social Security's long term financing problems are just that much worse.

NALU is encouraged this year by the near universal agreement that these flaws should be corrected. The only question now seems to be which decoupling proposal will be favored to replace the mechanism presently used to determine a prospective beneficiary's initial benefit. At this point it would be appropriate to state that only this part of the automatic mechanism should be replaced. NALU believes that the provision which keeps benefits up to date with the cost of living once a beneficiary is on the rolls works well and should be retained as is.

The decoupling plan NALU proposed to the Ways and Means Committee featured an indexing system based on wages rather than prices. From its study of the matter, NALU believes that indexing based on wages is preferable to indexing on prices because apparently price indexing would produce steadily reducing replacement ratios in the future, somthing which NALU does not support. NALU does not believe that replacement ratios should be decreased (or increased) appreciably from their present level, but rather be maintained in a stable course on into the future.

A stable course is necessary in order for individuals and businesses to plot their future with confidence. Workers and their employers must know how much they can count on from Social Security so they can build on the Social Security floor.

Pension planners must be assured that Social Security benefits (with which many pension plans are integrated) remain relatively stable as a percentage of earnings so that future contributions to these private plans can be assured. Ever-declining or even fluctuating replacement ratios would cause havoc with private plans.

Stabilizing replacement ratios, on the other hand, would have a most encouraging effect on creating new pension plans as long as replacement ratios were not too high. NALU's conclusion is that wage indexing is the best way of stabilizing replacement ratios, and therefore NALU supports that concept.

While NALU supports stabilizing replacement ratios, we believe stabilization should occur at a slightly lower level than present. NALU believes that the technical flaw in the Automatic Adjustment provision has pushed those ratios to a level higher than intended. We believe that this overexpansion should be corrected, but, while doing so, we would not recommend that anyone not yet on the rolls should experience a loss in benefits as compared with the benefits payable under the benefit formula in the law as it is at the time of the changeover. Therefore, NALU recommends that a savings clause be incorporated in the chosen decoupling plan to prevent such a loss.

In surveying the field of possible decoupling choices, NALU believes that the proposal put forward to this subcommittee on June 24th by Prof. Robert J. Myers, former Chief Actuary of the Social Security Administration, accurately reflects the results we would like to achieve. As mentioned above, stabilizing replacement ratios for future retirees at a slightly lower level than currently is our main objective, although the result may well be the long-term salvation of the entire Social Security System as we know it today. NALU, therefore, urges this Subcommittee to pass favorably on Professor Myers' concept, and thereafter recommend speedy action by the Congress.

OTHER LONG TERM FINANCING SUGGESTIONS

If the decoupling/indexed earnings plan which Professor Myers recommends, and NALU endorses, replaces the system now in use, the only additional financing probably needed by the system over the next 30 years (aside from the immediate increase discussed earlier) will be a 0.25% increase in the Social Security tax each on employers and employees probably implemented in the 1980's. As Professor Myers also points out in his testimony, this figure would have to be doubled if the decoupling proposal recommended by President Carter were adopted. Under other decoupling procedures the tax rate increase might not be needed at all because steadily lowered replacement ratios could wipe out completely the currently projected deficits.

In good conscience, though, NALU cannot recommend a system of appreciably lowered replacement ratios. Therefore, the only alternative is to recommend that a tax rate increase be imposed to meet the funding needs of a moderate system. As to the tax increase recommended above, people may indeed be reluctant to pay it. But in some respects the situation is analogous to health insurance; the premiums continue to go up because the costs of medical services continue to go up and more people use them. Most people complain, but pay the premiums anyway. The reason is obvious. The alternative is worse than paying the premiums.

The situation is the same with Social Security. Few people really want to pay the taxes necessary to fund the benefits of present beneficiaries. But almost everyone wants to receive benefits for himself some day. In order to get future benefits workers must pay taxes now. And, if workers are assured of their future benefits, we believe they will pay the taxes, more or less ungrudgingly.

OTHER MATTERS

Social security tax on self-employed persons—NALU supports the Administration proposal to restore the OASDI tax rate on self-employed persons to the relative level which prevailed from 1951 to 1972, namely one and one-half times the employee rate. We agree that self-employed persons should pay their own

way in the system. One and a half times the employee rate seems to be the proper level.

Shift of medicare funds to OASDI—Apparently the Hospital Insurance Trust Fund will need significant increases in revenue in the 1980's even though at present this fund seems to be in relatively better condition than the OASDI Funds. NALU understands that the shift in funds recommended by the Administration is based on the assumption that the President's Hospital Cost Containment Program will be enacted as submitted to the Congress, an assumption that seems now to be unwarranted.

NALU would recommend a wait-and-see attitude on this aspect of the President's Social Security plan. If significant cost savings are realized, the shift in funds could occur at a later date. Or, perhaps a reduction in the overall tax rate could be adopted since the tax rate increases NALU has recommended for OASDI are made independently of expected savings in Medicare.

In no event would NALU recommend that the taxes levied for HI be shifted to the OASDI program entirely, and HI be funded subsequently by general revenues. In our view, the Medicare program was "sold" to the American people as a social insurance program like Social Security and should remain part of the system. While HI benefits are not strictly wage-related, in that all beneficiaries are entitled to the same benefits but do not pay the same taxes because of varying income, the mere collection of the tax as a payroll deduction establishes that relationship. Removal of this connetion may cause HI to simply become a welfare program with a means test, a development we believe would lead to a substantial decline in public support.

Changes in dependency test for beneficiaries—NALU supports the recommendations of the Administration to counteract the effect of the recent Supreme Court decision which held that husbands have an unqualified right to claim dependent benefits based on wives' earnings in the same way wives previously claimed dependent's coverage based on a husband's earnings. NALU supports the principle of equal treatment for men and women under Social Security, but while holding for equality, the Supreme Court has placed an undue additional financial burden on the program.

The Administration proposal adheres to the principle of equal treatment, but at the same time it underscores the intent of Congress that dependency benefits should only be paid to persons who are in fact likely to be dependent.

Senator NELSON. We will adjourn these hearings, subject to the call of the Chair. We may have another day or two of hearings, if our review of the record indicates that we should do so.

[Thereupon, at 11:10 a.m., the hearings in the above-entitled matter were recessed, to reconvene at the call of the Chair.]

APPENDIX A

Communications Received by the Committee Expressing an Interest in These Hearings

Testimony of Milton J. Shapp, Governor, Commonwealth of Pennsylvania

I am Milton Shapp, Governor of the Commonwealth of Pennsylvania. I am glad to have this opportunity to testify on the Social Security proposals. There are three areas of concern I want to address: the negative effects of the proposed changes in the Social Security system on the Commonwealth of Pennsylvania, the underlying problems caused by mandatory retirement, and the value of removing regressive features of financing the Social Security system.

While there is much to be said to recommend elements of the President's proposals, there are hardships imposed by the proposed measures and other alternatives which you should consider:

> There are Costs to State Government: The Commonwealth of Pennsylvania would be forced to pay an additional $4 million in Social Security payments and would lose $5 million annually in interest income;
>
> Mandatory Retirement has produced the Social Security funding problems and forced retirement at 65 should not be allowed: Compulsory retirement greatly contributes to the financial problems of the Social Security system and eliminating mandatory retirement at age 65 is the single most important step which needs to be taken to return the system to financial solvency;
>
> Those earning less than $7.000 should contribute less than others to Social Security: The single regressive aspect of the Social Security taxing system should be repealed.

Effects on the Commonwealth of Pennsylvania

There are two aspects of the proposed changes in the Social Security program which would adversely impact the Commonwealth of Pennsylvania. First is the requirement that the deposits of the Social Security payroll deductions and employer contributions be made more frequently, and the second is the increase in the wage ceiling on which the employer pays Social Security tax would also result in additional cost to the Commonwealth of Pennsylvania.

The Commonwealth, as do other jurisdictions of government and private industry, invests the money it possesses in its treasury. By requiring more frequent deposits of Social Security payments, the Commonwealth loses the opportunity to invest these funds. On an annual basis, the loss to Pennsylvania would be over $5 million.

There is another, possibly more significant, cost to Pennsylvania. By extending the employer contribution to cover $23,400 of an employee's salary in 1979 and $37,500 in 1980, the Commonwealth would have to increase its payment to the Social Security system by $2 million in 1979 and by more than $4 million in 1980.

The total cost of the increases in the Commonwealth's payments for Social Security through 1980 would be more than $20 million.

Apart from the economic cost to Pennsylvania, the proposed changes do represent a possible threat to alternative retirement programs. In Pennsylvania, for example, the Commonwealth already pays the employer's share (5.85%) of the Social Security tax on all wages earned—but the amount taxed beyond the Social Security cut-off is deposited into the state pension system. By raising the ceiling for employer's contributions, the Social Security is using state tax capacity for its own purpose. This tax capacity is now used by Pennsylvania to support the state pension system.

As Governor of Pennsylvania, it is this question of the role of the Social Security system *vis a vis* the state pension system that concerns me most. By reducing investment income of the Commonwealth and by taking tax capacity from the state, the Social Seurity system is to some extent strengthened at the expense of the Commonwealth and its pension system.

Mandatory retirement at Age 65

I would now like to speak about the requirement of mandatory retirement at age 65, not only as the Governor of Pennsylvania, but also as a private citizen who is 65 years of age.

All analysis of the financial problems of the Social Security system stress the underlying demographic changes in America as a major cause of the system's weakness. The facts are clear enough. In 1955 there was one retiree for every seven workers; in 1960 there was one retiree for every four workers; by 1974 the ratio had risen to one for three. As this ratio increases, as it will, the transfer of income from workers to retirees which takes place as a result of Social Security will place an ever-increasing burden on the working population. The Board of Trustees of the Social Security system have predicted that the projected increase in the dependency ratio will result in a long-term deficit in the system for the next 75 years unless changes are made.

I submit to you that changing the laws which require mandatory retirement at age 65 would do more than any other single action to undermine the long term solvency of the Social Security system.

In some ways over the past forty years, the very success of Social Security has tended to distort our social attitudes toward work. When the framers of Social Security adopted age 65 as the trigger to qualify for benefits, I do not believe that they intended that our society should compel people to stop work. The Social Security system did, however, provide a penalty of one dollar in lost benefits for every two dollars earned over $3,000. This penalty encourages the employee to retire.

I believe that the Congress, through amendments to the Age Discrimination in Employment Act—such as those sponsored by Representatives Findley and Pepper and supported by the House Education and Labor Committee, should eliminate mandatory retirement. I believe that this Committee can see that such a reform will tend to significantly relieve current pressures on the Social Security fund by extending the period of contributions of the Social Security tax while shortening the period of receiving benefits.

If one fifth of the 1.6 million persons who will retire this year were able to work one additional year we would see a savings to the Social Security system of more than a billion dollars in one year.[1]

With a work force of over 90 million persons, the continued employment of 320,000 older persons woud not significantly alter employment and unemployment patterns while providing marked relief to the outlay pattern of Social Security.

I also favor consideration of adjustments to the Social Security retirement test as part of the strategy to give older Americans greater employment opportunities while receiving some retirement benefits. It is my understanding that some 1.4 million persons above the age of 65 lose more than $2.9 billion in benefits because of earned income in excess of the retirement test. I suspect that most of these persons continue to work primarily because their social security benefits are too low to sustain a decent life because of the rampant inflation in recent years.

In short, it is my belief that as you move forward to reform the fiscal underpinnings of the system you should also be seeking enhanced work opportunities for senior citizens. Getting older Americans back to work will be a boost to the general economy and should, on balance, materially contribute to the health and credibility of the fund itself.

Making social security more progressive

Finally, I would like to propose that the members of this committee consider strengthening the progressive taxation emphasis of the Social Security system.

As you know, Social Security was designed to guarantee minimum support for the aged, the disabled and dependent survivors. It has always been an

[1] Calculation: 320,000 workers multiplied by average annual benefits of $2,880 plus average wage of $9,000 multiplied by 320,000 and 11.7 percent Social Security tax equals $1.25 billion.

income redistribution program. Social Security transfers income from the young to the aged, from the working to the retired, and from the well-to-do to those less well-off. Looking solely at the transfer side and ignoring the tax method, Social Security is progressive, since it transfers benefits to the most needy population groups.

The use of the payroll tax in Social Security, however, has long been criticized for its regressivity. Although payroll taxes are politically acceptable, we cannot ignore the fact that we are taxing most severely the very group hit the hardest in our society—the working poor.

In 1974, $7.1 billion was paid in Social Security taxes by persons earning less than $7,000 per year.

Payroll taxes take no account of the number of dependents.

Payroll taxes take no account of unusual medical expenses.

To address the regressive nature of the payroll tax on employees earning $7,000 or less, I propose that a variable rate tax be charged for Social Security on income of less than $7,000. The 5.85% would be paid once an earner had earned more than $7,000 and the cut-off point for taxable earnings be extended to compensate the Social Security system for lost income. (Attached is a diagram which shows the taxing structure of the proposal.)

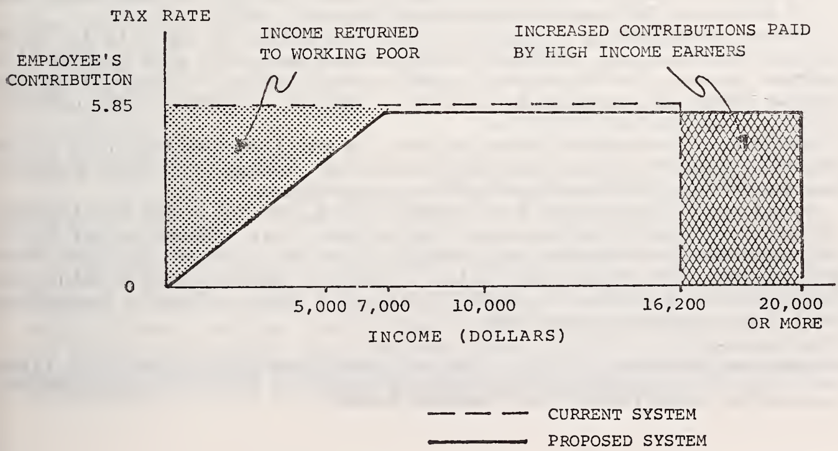
I hasten to point out that this proposal is in the spirit of the Social Security system—all workers would contribute on their earnings, and the well-to-do would contribute slightly more than those not so well-to-do.

The Social Security system is established as a desirable, permanent institution in American society. Designed in response to the crisis of the Depression to provide economic security, it is now needed by millions of Americans to prevent financial catastrophe of old age and retirement, disability and dependency.

The system itself, however, now faces fiscal catastrophe. Assets of the trust funds will be completely exhausted by the 1980's unless Congress acts now to assure a solid financial future. Over one hundred thirty-five million Americans will be affected, the 33 million currently receiving benefits and the 104 million currently paying their taxes into the system. Restoring the fiscal integrity of this vital institution, while preserving the humanitarian goals on which it was founded is an urgent task now before Congress.

President Carter's proposal to ensure a viable system is an approach which addresses the short and long range financial needs of the system. The proposals which you are considering would be strengthened considerably if you would make the system more progressive and humane by making the tax a variable one up to $7,000 and by eliminating mandatory retirement at age 65.

VARIABLE SOCIAL SECURITY TAX SYSTEM



Statement of Wendell R. Anderson

I want to commend the Finance Committee for its comprehensive review of proposals to improve the Social Security financing system, and to urge the Committee to give timely consideration to legislation to alleviate the inequitable burden placed on senior citizens by the Social Security "earnings limitation" as well.

There is no question that this retirement tax is a serious problem for a great many senior citizens. The present 50% tax on all earnings over $3,000 discourages able bodied, motivated persons from working and forces them to live on the fixed income to which they are restricted by Social Security. These are people who have a contribution to make to our society, and they should be encouraged to do so. By raising to $4,800 the amount which a Social Security retiree may earn, as is proposed in the bill introduced by Senator Bumpers, we can begin to alleviate the unfair restrictions placed on those who chose to work.

In Minnesota there are approximately 170,000 persons aged 65-72 on Social Security. For health and other reasons not all of these people can or have a desire to work, but a recent study done in Minnesota shows that an increasing number of senior citizens are looking for work to help offset the rapid rise in the cost of living. An inrease in the earnings limitation would allow them to keep a fairer share of their earnings.

The additional income allowed under the bill's provisions would provide these elderly citizens the benefits of an increased feeling of self worth and a more dignified old age.

As cosponsor of this legislation, I would hope that we could all see that the immense benefits of this legislation far outweigh its cost, and that its implementation cannot be delayed.

Statement of the Committee on Taxation, Financial Executives Institute [1]

The Carter Administration has proposed revamping the social security system to guarantee its financial integrity, both short and long term. The changes requested of the Congress include:

> Use of general revenues to compensate for social security taxes lost when the overall U.S. unemployment rate exceeds 6%.
>
> Removal of the present wage base ceiling per employee over a 3-year period through 1981; the employer would subsequently pay social security tax on his entire payroll.
>
> Raising the employee's wage base subject to tax by $600 in 1979, 1981, 1983 and 1985 in addition to increases already provided by current law. This would increase the wage base to $30,300 by 1985 instead of $27,900.
>
> Restoring the basic social security tax for self-employed persons to the traditional rate of one and one-half times that paid by employees. The 7.9% rate in 1977 would increase to 8.6 percent in 1979.

Certain miscellaneous changes were also recommended; e.g., (1) auxiliary benefits should be paid on the earnings record of the higher paid member of a married couple, (2) the current benefit formula scaled to cost-of-living increases should be amended to eliminate excessive adjustments for inflation inadvertently enacted in 1972, etc.

Although action must be taken to place the social security fund on a sound financial basis, we believe that proposals to use general tax revenues and to tax employers on their entire payroll are inappropriate.

Social security derives its fiscal integrity from separate taxing and funding. Whenever a benefit is added, under this concept, a tax is levied to pay for it. If general revenues are to be used, that discipline which to date has been characteristic of social security will be lost. Tapping general revenues would permit benefit increases to rise to politically-attractive levels without a responsible financing mechanism to back it up.

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[1] Financial Executives Institute is the recognized professional association of 10,000 senior financial and administrative executives in more than 5,000 business organizations representing a broad cross-section of American industry.

Social security should be available to every American on a contributory, earned-right basis. Those who receive social security should not be led to feel that they are accepting funds from a welfare program. Their preference is to receive funds from a contributory system to which they have paid their share and from which they are receiving earned benefits.

The use of general tax funds would erode those values—particularly since the federal government is already operating at a substantial deficit. No surplus general funds even exist to support the social security system. Therefore, the tax burden once again would become a responsibility of the already heavily taxed middle income American. The insurance and earned-benefits aspects of social security should not only be maintained but, if possible, should be strengthened.

Though Social Security Commissioner Cardwell insists that a general fund contribution would be largely a "paper transaction," the concept of a sound and self-sustaining system would be compromised at the expense of an increase in national debt and inflationary spiral. Moreover, use of the unemployment level as a trigger would only exacerbate the problem, since times of high unemployment coincide with times of high demand on federal revenues by other programs.

The proposed corporate tax on entire payroll occurs inopportunely just when new proposals are being made to aid capital formation. Extending the social security tax to full payroll would likely:

1. Hamper the business recovery, inhibit capital formation and cut into general revenues by adding a tax deductible item.
2. Prove inflationary to the degree that employers attempted to recover the additional tax through price increases.
3. Encourage fiscally burdened state and local governments to consider withdrawing from social security—thereby compounding the system's problem.

The existing financing structure which calls for equal contributions by employers and employees has stood the nation in good stead for forty years. It has survived every economic downturn and change of political administration. The soundness of the principle has been proven and should not be subverted for short-term considerations.

We support equal increases in social security tax rates, as needed, on employers and employees. A direct, payroll-related tax provides strong fiscal discipline and should not be altered. Although it is alleged that the social security tax is regressive, the benefit formula is quite the opposite—lower income workers receive far larger benefits from social security relative to their earnings than do middle or upper income persons.

We further believe that two existing problems directly affect the soundness of the social security system. First is the "double indexing" of benefits to compensate for inflation and wage increases (begun in 1972). Double indexing clearly serves to overcompensate for the effects of inflation. It must be stopped because it costs too much.

The second problem is the growing exodus of state and local employees from the social security system and the failure to extend the system to millions of federal civilian employees. This compromises the system's viability. Many local, state, and federal workers serve sufficient time on the public payroll to qualify for generous pension benefits (at great expense to the taxpayer even though their plans may be contributory)—then qualify for additional benefits under social security by working for ten years or even less for a covered employer. In general, their social security benefits are out of proportion to their contributions.

Federal, state, and local employees should be included in the social security system and contribute to it. Equivalent payments should, of course, be made by their employers, i.e., the appropriate governmental units. Government pension systems should then be integrated with social security in a manner similar to that used by the pension plans of many of the country's private employers.

In summary, we agree that the social security system should be made financially sound as soon as possible, but not primarily at the expense of the employer or middle-income taxpayer and not so as to lose fiscal restraints on benefits. Double indexing must be stopped, rate increases, when needed, should fall equally on employers and employees, steps should be taken to discourage withdrawal by the few groups able to opt out, and coverage should be extended to government workers not currently enrolled in social security.

STATEMENT OF WILLIAM H. DEMPSEY, PRESIDENT OF THE ASSOCIATION OF AMERICAN RAILROADS, AND BY CHARLES I. HOPKINS, JR., CHAIRMAN OF THE NATIONAL RAILWAY LABOR CONFERENCE

William H. Dempsey is the President of the Association of American Railroads. The Association represents almost all of the nation's railroads in a wide variety of matters, including legislative matters, that concern the railroad industry. Charles I. Hopkins, Jr., is the Chairman of the National Railway Labor Conference, succeeding Mr. Dempsey in that position on April 1, 1977. The Conference represents almost all of the nation's railroads in national collective bargaining with the unions representing their employees and in regard to other matters concerning labor-management relations in the railroad industry. This Statement is directed to the bill drafted by the Department of Health, Education, and Welfare (S. 1902) for the purpose of restoring the financial integrity of the social security system in accordance with the President's May 9, 1977 Message to the Congress. We are making this Statement jointly, on behalf of the railroads, because that bill may have impacts upon collective bargaining in the railroad industry as well as otherwise involving matters that are important to all of the railroads.

Since a 1951 amendment to the Railroad Retirement Act of 1937, the railroad employment of individuals who have less than 10 years of such employment when they retire is placed directly under the social security system and included with other employment of such individuals for purposes of determining the social security benefits to which they are entitled. And, while the Congress has provided a separate railroad retirement system for railroad employees with 10 or more years of service, a portion of the benefits paid and of the employment taxes imposed pursuant to that system are directly equivalent to benefits paid and taxes imposed pursuant to the social security system.

Hence, legislation affecting social security benefits or taxes is a matter which directly concerns the railroads. In addition, and particularly in regard to the legislation now pending before this Committee, it is important to the railroads that social security legislation does not adversely affect that portion of the railroad retirement system (including the taxes paid by the railroads thereunder) which is *not* equivalent to social security, but rather constitutes a second level of benefits and taxes over and above the social security level.

In general, the railroads object to the proposal which would eliminate the present maximum limit upon the wages subject to the employment taxes paid by employers. But even if that proposal should otherwise be adopted, it certainly should not apply to that portion of the tax imposed on the railroads by the Railroad Retirement Tax Act which is *not* equivalent to the social security tax upon employers. We also urge that the proposal for contributions of funds from the General Treasury to the social security trust funds in periods of high unemployment should be revised, if otherwise adopted, to avoid an adverse effect upon the railroad retirement system which we believe to be unintended and which certainly is unjustified. We support the proposed indexing amendments and the proposed equal rights amendments, and we urge that similar equal rights amendments be made to the Railroad Retirement Act of 1974 so as to eliminate gender-based distinctions in that Act. Finally, we urge that the legislation contain a provision placing the financial interchange between the railroad retirement and social security systems on a current or accrual basis.

We believe that our specific comments in regard to these matters can be better understood if they are prefaced by a fuller, although necessarily summary, description of the relationship between the railroad retirement and social security systems. Hence, we will attempt first to provide that description, including some historical background.

THE RELATIONSHIP BETWEEN THE RAILROAD RETIREMENT AND SOCIAL SECURITY SYSTEMS

When the railroad retirement system was created pursuant to the Railroad Retirement Act of 1937 (50 Stat. 307) and the Carriers' Taxing Act (50 Stat. 535),[1] there was no direct relationship between that system and the social

[1] The Carriers' Taxing Act, as amended, now is known as the Railroad Retirement Tax Act, and is included in the Internal Revenue Code of 1954, 26 U.S.C. §§ 3201–3232.

security system. Nevertheless, the two systems performed generally similar functions in their respective spheres. Thus, they generally provided the same kind of benefits which were financed by employment taxes imposed equally upon both employers and employees, although both the benefits paid and the taxes imposed by the railroad retirement system were higher than under the social security system. See, *e.g.*, Report of the Commission on Railroad Retirement (June 30, 1972), at 6–7, 58–61.[2] (Hereinafter, "CRR Report.") Moreover, as "the social security system grew in scope and adequacy, the railroad retirement system [was] adjusted to keep abreast," CRR Report at 7, although continuing to pay a higher level of benefits. This included the provision of survivor and spouse benefits by 1946 (60 Stat. 722, 729) and 1961 (65 Stat. 683) amendments to the Railroad Retirement Act of 1937. Those new benefits generally were patterned after, and justified by reason of, similar benefits previously added under the social security system,[3] and include the only gender-based distinctions made by the railroad retirement system.

Some partial steps towards integrating the railway retirement and social security systems were taken by the Congress in the 1951 amendments to the Railroad Retirement Act of 1937. In addition to transferring to the social security system the railroad service of (and taxes paid in regard to) individuals who had less than ten years of such service upon retirement, the Congress then enacted what has become known as the "financial interchange" between the railroad retirement and social security systems (65 Stat., at 687). The financial interchange "was designed to establish the principle that the Federal old-age and survivors insurance trust fund should be maintained in the same position it would have been if there had been no separate railroad retirement system," [4] so that the Congress "in substance, declares it to be the congressional policy that the social security system shall neither profit nor lose from the existence of the separate railroad retirement system." [5]

In effect, the financial interchange "provided that each year the Railroad Retirement Account would pay the social security trust funds the amount of taxes which would have been contributed by current railroad workers (and employers), had they been covered by social security," while the "social security trust funds would pay the Railroad Retirement Account the benefits which would have gone to current railroad retirement beneficiaries, had they been under social security coverage." CRR Report, at 62. The "actual transfer of funds was made retroactive to 1937," and the "settlement is made on a net basis',' but the "gross reimbursement to the Railroad Retirement Account by OASDI" was "reduced by the dual OASDI benefits already paid directly to railroad beneficiaries by social security." *Ibid.*

While the Congress through the financial interchange thus substantially integrated the two systems in regard to the financing of that portion of railroad retirement benefits that generally is equivalent to social security benefits, unfortunately it did not then integrate or coordinate the benefits themselves. While not expected at the time, over a period of years that resulted in disastrous adverse effects upon the financial health of the railroad retirement system. The failure to coordinate the social security portion of railroad retirement benefits with social security benefits gave rise to a "dual benefit" problem. If an individual had sufficient railroad and non-railroad employment to qualify for benefits under both systems, the total of the social security portion of his railroad retirement benefits plus his direct social security benefits substantially exceeded the amount of the social security benefits that would have been paid to him if based upon combined railroad and non-railroad service. And, the cost of this excess or "windfall" social-security type benefit was paid entirely by the railroad retirement account, and thus out of that portion of railroad retirement taxes that exceeded social security taxes. This resulted from the fact that, under the financial interchange, the reimburements to the railroad retirement account from the social security trust funds were reduced by the amount of the social security benefits paid directly by the social security system.[6]

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[2] That Report is entitled "The Railroad Retirement System: Its Coming Crisis."

[3] See, *e.g.*, H. Rept. No. 1989, 79th Cong., 2d Sess. (1946), at 2, 4, 9, 13–21; S. Rept. No. 1710, 79th Cong., 2d Sess. (1946), at 3–4; S. Rept. No. 890, 89th Cong., 1st Sess. (1951), at 2, 8 , 23, 64, 68.

[4] H. Rept. No. 1215, 82d Cong., 1st Sess. (1951), at 13.

[5] S. Rept. No. 890, *supra* at 8.

[6] See, *e.g.*, H. Rept. No. 93–1345, 93d Cong., 2d Sess. (1974), at 2–3, 7–8; S. Rept. No. 93–1163, 93d Cong., 2d Sess. (1974), at 2–3, 7–9.

The House Committee on Interstate and Foreign Commerce stated, in 1974, that the "lost reimbursement to the Railroad Retirement system over the years arising out of this situation is in excess of $4 billion," and that:

"The deficit in the Railroad Retirement Account at present is almost entirely due to the lost reimbursement to the Account arising out of the receipt of Social Security benefits by persons who also are receiving Railroad Retirement benefits. As was stated earlier in this report, this lost reimbursement amounts to 7.72% of taxable payroll, out of a total deficit of 9.05%, or $451 million a year out of a total deficit of $529 million. In other words, were it not for the problem of dual beneficiaries, the railroad retirement system would be almost completely solvent." H. Rept. No. 93–1345, *supra* at 2, 7. Those statements were reiterated by the Senate Committee on Labor and Public Welfare. S. Rept. No. 93–1163, *supra* at 2, 8.

By 1970, the Congress had become sufficiently concerned about the financial integrity of the railroad retirement system to establish the Commission on Railroad Retirement to "conduct a study of the railroad retirement system and its financing for the purpose of recommending to the Congress on or before July 1, 1971, changes in such system to provide adequate levels of benefits thereunder on an actuarially sound basis." 84 Stat. 791, 793. The deadline for the Commission's report subsequently was extended to June 30, 1972 (84 Stat. 101. 102). and the result was the June 30, 1972 Report of the Commission on Railroad Retirement to which we have already referred. Among other things, the Commission recommended that future accruals of excess or windfall dual benefits should be terminated, while preserving the equities of those who had already qualified for such benefits; and that a "two-tier" system should be created which would clearly separate the social security benefits (Tier I) and the additional or supplemental benefits (Tier II) paid to retired railroad employees. See, *e.g.*, CRR Report, at 3–4, 367–369, 502–503.

The Congress initially reacted, in 1972, by enacting a statutory direction that the "representatives of employees and retirees and representatives of carriers," no later than March 1. 1973, submit to the Congress "a report containing the mutual recommendations of such representatives based upon their negotiations and taking into account the report and specific recommendations of the Commission on Railroad Retirement designed to insure" the actuarial "solvency" of the railroad retirement system. 86 Stat. 765, 767. While unable to resolve all of the complex issues involved, the representatives of the railroads and their employees did agree upon and propose to the Congress "practical legislation as a first step in the resolution of these difficult and complex long-range problems.[7] In particular, as we shall explain, they proposed an adjustment of the tax burden and a clear separation of that portion of railroad retirement taxes which is equivalent to social security taxes from that portion which is over and above the taxes imposed under the social security system.

In a 1973 statute enacting the legislation thus proposed by the railroads and unions, the Congress also directed the creation of a joint railroad-union negotiating committee or "group" to submit to the Congress, by April 1, 1974, their "joint recommendations for restructuring the railroad retirement system in a manner which will assure the long-term actuarial soundness of such system, which recommendations shall take into account the recommendations of the Commission on Railroad Retirement." 87 Stat. 162, 165. The Congress further directed that the "joint recommendations contained in such report shall be specific and shall be presented in the form of a draft bill." *Ibid.* The joint railroad-union committee did agree upon and submit a proposed bill which, with some changes, was enacted as the Railroad Retirement Act of 1974 (thus superseding the 1937 Act). 88 Stat. 1305, 45 U.S.C. §§ 231 *et seq.*

Apart from a special tax imposed upon the railroads to pay for certain "supplemental annuities,"[8] prior to the 1973 statute to which we have referred, the Railroad Retirement Tax Act imposed a tax rate of "10.60 percent on rail-

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[7] H. Rept., No. 93–204, 93d Cong., 1st Sess. (1973), at 2; S. Rept. No. 93–202, 93d Cong., 1st Sess. (1973), at 3.

[8] That special tax was first enacted in 1966 by 80 Stat. 1073, and is now provided for by subsections (c) and (d) of 26 U.S.C. § 3221. The Railroad Retirement Board makes quarterly determinations of the amount per railroad employee man-hour which is necessary to pay the supplemental annuities, and that amount becomes the rate of tax per employee man-hour which is imposed for the next quarter. Such amounts are paid into (and the supplemental annuities are paid out of) a railroad retirement supplemental account, which is separate and apart from the basic railroad retirement account.

road employees and employers alike," thus exceeding the 5.85 percent imposed upon employers and employees under the Federal Insurance Contributions Act by 4.75 percent with respect to each group. The maximum taxable compensation was (and now is) the same, except that the maximum (for both employers and employees) is on a monthly basis under railroad retirement and on an annual basis under social security, so that the railroad retirement monthly maximum is one-twelfth of the social security annual maximum. See H. Rept. No. 93–204, *supra* at 12–13; S. Rept. No. 93–202, *supra* at 15.

The 1973 Act reduced the tax rate imposed upon railroad employees by 4.75 percent to 5.85 percent, so as to impose the identical tax rate upon employees as is imposed by the social security system. Concommitantly, the tax rate imposed upon the railroads was increased by 4.75 percent to 15.35 percent. However, "the 15.35 percent" was divided "into 9.5 percent plus the social security tax rate on employers (5.85 percent)" so as "to avoid the need for amending the Railroad Retirement Tax Act any time the social security tax rate is changed." H. Rept. No. 93–204, *supra* at 13; S. Rept. No. 93–202, *supra* at 16. Hence, Section 3201 of the Internal Revenue Code now imposes upon railroad employees "a tax equal to the rate of tax imposed with respect to wages" by Section 3101 in regard to employees under social security, applicable to "so much of the compensation paid in any calendar month to such employee for services rendered by him as is not in excess of an amount equal to one-twelfth of the current maximum annual taxable 'wages' as defined" by Section 3121 for purposes of social security. Subsection (b) of Section 3221 of the Code likewise imposes upon the railroads the rate of tax imposed upon employers under social security by Section 3111, and subsection (a) of Section 3221 imposes upon the railroads an additional "9.5 percent of so much of the compensation paid in any calendar month by such employer for services rendered to him as is, with respect to any employee for any calendar month, not in excess of an amount equal to one-twelfth of the current maximum annual taxable 'wages' as defined" by Section 3121 for purposes of social security.[9]

As we have noted, and as the committees which considered the legislation recognized, the 1973 Act "carrie[d] out the terms of an agreement reached through nationwide collective bargaining" between the railroads and unions representing their employees. H. Rept. No. 93–204, *supra* at 2; S. Rept. No. 93–202, *supra* at 3. The proposed legislation thus agreed upon was part of a broad agreement, contingent upon the enactment of that legislation, revising and extending national wage and rules agreements with the unions for an additional 18 months. The railroads and the unions generally recognized that the removal from the employees of the 4.75 percent in excess of the social security tax rate, and the assumption of that additional amount by the railroads, was the equivalent of a wage increase of slighlly more than five percent. But while "all of the other major railroad unions accepted the Carriers' view of the tax pickup as a form of wage increase in real terms," the Sheet Metal Workers' International Association "did not" and urged that its members should receive a wage increase that did not take the tax adjustment into account. Report of Emergency Board No. 185 (July 2, 1974), at 3. Emergency Board No. 185 agreed with the railroads and urged that union to settle on the same basis as the other unions in regard to wages (*id.*, at 3–6), which eventually was done.

The enactment of the Railroad Retirement Act of 1974 substantially completed the coordination of the railroad retirement and social security systems insofar as the social security level of taxes and benefits is concerned. The 1974 Act retained the eligibility requirements for benefits thereunder that were contained in the 1937 Act as amended, and which differ in some respects from those contained in the Social Security Act. However, the payment of excess or windfall dual benefits was terminated, except insofar as the equities of those already eligible for such benefits were preserved, and a "two-tier" system was established in substance.

The nature and significance of this two-tier system is explained in the Committee reports, as follows:[10]

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[9] In addition, as we have already noted, subsections (c) and (d) of Section 3221 continue to impose upon the railroads a special tax for payment of certain supplemental annuities. We note, also, that Section 3211 of the Code imposes upon certain employee representatives a tax that is equal to the combined tax imposed upon railroads and railroad employees.

[10] H. Rept. No. 93–1345, 93d Cong., 2d Sess. (1974), at 19; S. Rept. No. 93–1163, 93d Cong., 2d Sess. (1974), at 19.

"Although the bill would not adopt the 'two tier' system in form, essentially it does so in substance. One major component of the new railroad retirement benefit formula which the bill would establish is in essence a social security benefit. That component would be calculated on the basis of the formula provided in the Social Security Act as applied to all of the employee's wages and services, non-railroad as well as railroad. All future increases in the level of social security benefits would be applied to this component of the new railroad retirement formula, both to people who retire after the increases become effective and to people on the retirement rolls, in the same way as if they were social security beneficiaries.

"Under the financial interchange between the railroad retirement and social security systems, which the bill would retain, this social security component would be financed by the social security system as at present, and that portion of both employer and employee railroad retirement taxes that are the equivalent of social security taxes would be transmitted to the social security system as at present.

"Consequently, when taken together with the phaseout of dual benefits, these provisions of the bill would accomplish the principal goal of the Commission's 'two tier' recommendation—a clear and permanent isolation of the social security component of railroad retirement benefits based upon combined railroad and non-railroad service and compensation, from the additional component riding on top of social security which is based on railroad service and compensation alone and is financed by the railroad industry."

The "social security component of railroad retirement benefits" commonly is referred to as "Tier I benefits," and "the additional component riding on top of social security" commonly is referred to as "Tier II" benefits. So, too, the portion of railroad retirement taxes equivalent to social security taxes commonly is referred to as "Tier I taxes," and the additional portion of railroad retirement taxes commonly is referred to as "Tier II taxes." We shall use those terms from time to time hereinafter in this Statement. The Committees which recommended enactment of the 1974 Act noted, among oher things, that as a result of that Act and the 1973 Act Tier II constitutes "in essence, a company pension program administered, for historical reasons, by the Federal Government," and thus those Committees contemplated that "[f]uture changes" therein "will arise out of collective bargaining between the carriers and the unions." H. Rept. No. 93–1345, *supra* at 16–17; S. Rept. No. 93–1163, *supra* at 16–17.

Upon the basis of actuarial estimates provided by the Railroad Retirement Board and its staff, the railroads and unions understood that their proposed bill would, if enacted, reduce the actuarial deficit of the railroad retirement account to less than one percent of taxable payroll, and assure a positive balance in that account at least through the year 2000. Hence, it was contemplated, as the Committee reports stated, that enactment of the 1974 Act would place the railroad retirement system "on a sound financial basis." H. Rept. No. 93–1345, *supra* at 1; S. Rept. No. 93–1163, *supra* at 1. Subsequently, however, in the Thirteenth Actuarial Valuation of the Railroad Retirement Account, the Actuarial Advisory Committee estimated that the actuarial deficit had been reduced to only 3.59% and that the Account will be exhausted in 1986.[11]

While that estimate is a matter of serious concern, it basically involves Tier II and an immediate solution is not required. Thus, while the railroads have included the topic of possible means of resolving the problem in the current round of negotiations with the unions upon new national wage and rules agreements, which negotiations are now in progress, in our view it is not a matter which generally should concern the Committee or the Congress in connection with the proposed legislation to which this Statement is addressed. As we shall point out in discussing the specifics of that proposed legislation, however, certain of its features could affect the financial condition of the railroad retirement account, which is a factor that the Congress properly should consider in passing upon those features.

In addition, as we also shall explain below, a significant reason for the estimate that the railroad retirement account will be exhausted in 1986 was the failure of the Congress to include in the 1974 Act a provision, which had been included in the bill proposed by the railroads and unions, to put the financial

[11] See 1976 Annual Report of the Railroad Retirement Board, at 51–53.

interchange on a current basis. Sine that provision was omitted because of a belief that the Congress should await legislation dealing with the financial problems of the social security trust funds, rather than because of a lack of merit, inclusion of that provision in the pending legislation appears to us to be appropriate and desirable.

MAXIMUM TAXABLE WAGE BASE

Under the existing law, Section 230 of the Social Security Act provides that the "contribution and benefit base" utilized in determining annuities is increased eah year, over an initial base in 1973 of $13,200, by a formula based upon increases in average wages. 42 U.S.C. § 430. Section 3121(a) of the Internal Revenue Code provides that the amount thus determined shall also constitute the maximum annual taxable wage base for purpose of the social security taxes paid by both employers and employees. 26 U.S.C. § 3121(a). Under Section 3201 of the Code, the maximum taxable monthly wage base for railroad employees is one-twelfth of the maximum taxable annual wage base thus established for social security, and under Section 3221 of the Code the maximum taxable monthly wage base for railroad employers similarly is one-twelfth of the annual social security maximum.

Hence, both employers and employees are subject to the same maximum under both the railroad retirement and social security systems, and essentially the same maximum applies to both systems, although the railroad retirement system utilizes a monthly maximum while the social security system utilizes an annual maximum. At present, the monthly maximum taxable wages for railroad retirement taxes is $1,375, while the annual maximum for social security taxes is 12 times that amount or $16,500. However, the maximums thus applicable under present law are indexed so as to move upward with wage inflation.

Section 103 of the bill submitted by the Department of Health, Education, and Welfare would destroy that congruity, which has existed from the very beginning of the railroad retirement and social security systems, between the maximum taxable wage bases applicable to employers and employees. The maximum taxable annual wage base for employers would be increased arbitrarily to $23,400 for 1979 and $37,500 for 1980, and no maximum whatsoever would be applicable for years after 1980 so that employers would pay taxes based upon all wages of their employees. On the other hand, employees would continue to be subject to maximums determined under the present law, apart from arbitrary $600 increases in 1979, 1981, 1983 and 1985, under Section 104 of the bill. Moreover, those changes in the maximum taxable annual wage bases for purposes of social security taxes would also be made applicable (on a monthly basis, except insofar as all limitations would be removed as to employers after 1980) to the railroad retirement taxes paid by the railroads and their employees. And that would be true of the 9.5% additional Tier II tax paid by the railroads as well as of the 5.85 percent Tier I tax, paid by both the railroads and their employees, which is the equivalent of the social security tax rate.

The railroads are strongly opposed to any change in the maximum taxable wage bases provided by present law. As we have noted, under the present law the maximums are adjusted annually to allow for inflation. Any further increase in those maximums, and of course the elimination of any limit upon taxable wages, effectively increases the employment tax burden. And, the plain fact of the matter is that the employment tax burden now imposed upon the railroads is close to intolerable, so that there is no room for further significant increases.

The railroads now pay the 5.85 percent Tier I tax that is equivalent to social security taxes, plus the additional 9.5% basic Tier II tax, plus the supplemental tax which as presently calculated amounts to about 1.85% of taxable payroll, for a total of 17.2 perent of taxable payroll. We estimate that the proposed increase in the maximum to $23,400 in 1979 would be equivalent to another 0.6 percent of current taxable payroll if limited to the Tier I tax and 1.7 percent of current taxable payroll if applied to both the Tier I and the Tier II taxes. And, once the maximum is eliminated altogether in 1981, if the proposed bill should be enacted, the estimated increase would be 1.% of

current taxable payroll if limited to Tier I and 2.6 percent of taxable payroll if applied to both Tier I and Tier II taxes. Since taxable payroll in 1976 (about $7.5 billion) was almost 86% of total payroll (about $8.75 billion), in terms of total wages paid by the railroads the increases in regard to Tier I taxes would be about 0.5% as of 1979 and 0.9% in 1981 when no maximum would be applicable, and in regard to both Tier I and Tier II would be 1.4% in 1979 and 2.3% in 1981.

Tax increases of this magnitude must be a matter of great concern to any industry, but they will be particularly harmful to the railroad industry which already has severe financial problems. The bankruptcy of several railroads within recent years is well known to the Congress, and the industry as a whole is burdened by inadequate earnings. In 1976, for example, the rate of return of all Class I railroads on net investment was only 1.49%. Moreover, even to the extent that increased taxes could be passed on through higher freight rates without adversely affecting traffic, the result would be to boost an inflationary spiral that even now is of utmost concern to almost everyone.

Furthermore, if some upward adjustment of the maximum taxable wage bases should be adopted, there is no justification for differentiating between employers and employees in that regard. From the beginning, the maximums applicable to employers and employees have been identical, under both the railroad retirement and the social security systems. It hardly is unfair to require the employees to pay half when they receive all the benefits, and that requirement serves the important purpose of inhibiting political and other pressures for inordinate benefit increases as well as making possible a more realistic tax burden upon employers. We estimate that on an overall basis, if the proposed bill is enacted, the railroads' tax base will be about 11 percent more than the tax base applicable to their employees in 1979, and about 17 percent more than the base applicable to their employees in 1981.

We are even more concerned, if possible, by the proposal to change the taxable wage base in regard to Tier II railroad retirement taxes as well as to social security taxes and the Tier I railroad retirement taxes that are the equivalent of social security taxes. Indeed, we can hardly believe that HEW so intended, even though its bill clearly would have that effect, since President Carter in his message referred only to the problems of the social security system and the bill submitted by HEW does not otherwise directly apply to the railroad retirement system.

But however that may be, if the Congress should in the present circumstances change the maximum taxable wage base applicable to Tier II railroad retirement taxes, it would undermine the primary purpose of establishing the two-tier system. As we have already explained, the 1973 amendment of the Railroad Retirement Tax Act and the Railroad Retirement Act of 1974 clearly and intentionally separated the railroad retirement taxes and benefits that are the equivalent of social security taxes and benefits (Tier I) from those that are in excess of social security taxes and benefits (Tier II). Thus, while it was contemplated that the level of Tier I taxes and benefits would be adjusted automatically with adjustments in social security taxes and benefits, it also was contemplated that future adjustments in Tier II taxes and benefits would be primarily a matter to be worked out by the railroads and unions in collective bargaining. As the House Interstate and Foreign Commerce Committee and the Senate Labor and Public Welfare Committee remarked at the time, Tier II constitutes "in essence, a company pension program," even though "administered, for historical reasons, by the Federal Government," so that future changes "will arise out of collective bargaining between the carriers and the unions." See p. 13, *supra*.

Indeed, as we have noted, one of the subjects in the national negotiations currently in progress between the railroads and the unions representing their employees is possible measures to propose to the Congress in view of the financial problems of the railroad retirement system. Because of the financial interchange between the railroad retirement and social security systems, in regard to Tier I taxes and benefits, those problems are Tier II problems and any proposed solution necessarily will be in terms of Tier II finances and benefits. Exclusion of Tier II taxes from any changes in the maximum taxable wage bases made by the legislation presently before the Congress will not affect the social security system or its financial problems in any way.

We have prepared a revision of Section 103 of HEW's bill which would limit the proposed changes in the maximum tax base applicable to the railroads to the Tier I tax (Section 3221(b) of the Code), but which otherwise would not change that proposal despite our opposition to the proposed changes in general. A copy of that proposed revision is attached as Appendix A hereto. We concede, of course, that if the maximum taxable wage base is changed for purposes of social security taxes a similar change should be made for purposes of the Tier I railroad retirement taxes that are the equivalent of social security taxes. That is part of the concept of the two-tier system, which in effect integrates Tier I with social security, just as the separateness of Tier II is a part of that concept. For the reasons we have stated, we believe that the Congress should not change any aspect of the provisions of the existing law regarding maximum taxable wages, but if some changes are made they certainly should not be applied to Tier II railroad retirement taxes.

CONTRIBUTIONS FROM THE GENERAL TREASURY

Section 102 of the bill submitted by HEW provides for contributions from the General Treasury to the social security trust funds in periods of high unemployment. While we see some dangers in such an approach, there also are some circumstances in which partial assistance from the General Treasury in meeting the ever increasing costs of paying benefits may be justified. Our principal concern in regard to this aspect of the bill is that, if enacted in its present form, it will have an adverse effect upon the railroad retirement system that surely was not intended and cannot possibly be justified. This results from the fact that the proposed Section 102 has failed to take account of the financial interchange between the railroad retirement and social security systems.

We have already described the financial interchange and the fact that it is intended to place the social security trust funds in the same position that they would be if the railroads and railroad employees were covered directly by the social security system. The formula utilized in the proposed Section 102 for determining the amount of the contributions to the social security trust funds includes a factor based upon the amounts appropriated to those funds in a calendar year by reason of the social security taxes paid in that year. If the railroads and their employees were directly a part of the social security system, the amounts so appropriated would be larger which, under the proposed formula, would increase the amount of the contributions out of the General Treasury. Under the financial interchange, the social security trust funds will subtract from the railroad retirement account an amount based upon the supposition that the railroad retirement account shared in the contributions, even if in fact it does not do so.

In effect, therefore, the social security system would be subsidized in part by the railroad retirement system. Moreover, the money thus transferred from the railroad retirement account to the social security trust funds would come entirely out of Tier II taxes (which at present are paid by the railroads) since all Tier I railroad retirement taxes are transferred to the social security trust funds under the financial interchange in any event. The staff of the Railroad Retirement Board has estimated that, over the first four calendar years, the loss to the railroad retirement account through the financial interchange will total about $153 million. There is no justification for imposing such a drain upon the railroad retirement account regardless of its amount. Whatever may be the reasons or justifications for making contributions out of the General Treasury to the social security trust funds in times of high unemployment, they obviously have no application whatsoever to making such contributions out of the railroad retirement account.

Attached as Appendix B hereto is a proposed revision of Section 102 of HEW's bill which is intended to remedy this patent defect. It would include the Tier I (but not the Tier II) railroad retirement taxes appropriated to the railroad retirement account in the formula utilized to determine the amounts to be contributed, and would provide for contributions to be made to the railroad retirement account as well as to the social security trust funds.

We want to emphasize, however, that it is our understanding and intention that the amounts so transferred to the railroad retirement account would in turn be transferred from that account to the social security trust funds under

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the financial interchange. While there may be some reasons for assistance from the General Treasury in the financing of Tier II benefits, that matter should not be considered at this time or in connection with the pending legislation. Indeed, we have no fundamental objection to a provision which would transfer any contributions directly to the social security trust funds, rather than running them through the railroad retirement account, or which would simply provide in effect that the railroad retirement account shall not be affected by contributions made under Section 102 notwithstanding the financial interchange.

We have adopted the approach utilized in the attached proposed revision of Section 102 only because it is more consonant with the purposes of Section 102 as well as with the purposes of the financial interchange and the two-tier system. Railroad employees are part of the nation's work force and may be affected by unemployment as well as employees in other industries. And, Tier I of railroad retirement has been coordinated with social security, including the provision for the financial interchange, although maintained as part of a separate system. Hence, it seems logical to us to include Tier I railroad retirement taxes for purposes of determining the amounts to be contributed, and to utilize the established financial interchange in funneling any contributions resulting from such inclusion to the social security trust funds. But however it may be done, plainly Section 102 as proposed by HEW should be revised to make certain that the contributions to the trust funds in fact are made entirely from the General Treasury and that the railroad retirement account will not be adversely affected.

INDEXING OF SOCIAL SECURITY BENEFITS

Title II of HEW's bill is a complex provision which, as we understand, is intended to correct a serious flaw in the Social Security Act in that the level of benefits is automatically adjusted by formulae which couple the effects of both increases in the Consumer Price Index and increases in average earnings. This results in benefit increases in excess of anything that could be justified by inflation, and in time (unless corrected) could lead to social security benefits alone that exceed, upon retirement, an employee's highest wage earnings. Since Tier I railroad retirement benefits also are adjustd automatically in conformity with adjustments in like social security benefits, this defect is applicable to Tier I of the railroad retirement system as well as to the social security system. And, it indirectly affects Tier II of the railroad retirement system to some extent, as in regard to survivor benefits. The Tier I survivor benefit is 100% of what social security would pay and Tier II is an additional 30%.

Consequently, the railroads support Title II of the bill submitted by HEW, which would "decouple" the automatic adjustment formulae and provide a means for adjusting or indexing social security benefits that is more closely attuned to the effects of inflation. No amendment of the Railroad Retirement Act is necessary, since under its present provisions Tier I benefits automatically will be adjusted as and when social security benefits are adjusted—however that is done. So, too, insofar as Tier II benefits are related to the level of Tier I (and thus of social security) benefits, that will continue to be true regardless of what that level may be.

ELIMINATION OF GENDER-BASED DISTINCTIONS

There are several instances in which the Social Security Act provides for the payment of benefits to females in circumstances in which benefits are not payable to males, such as where widowers but not widows of deceased employees are required to prove that they were financially dependent upon such employees. Some of those gender-based distinctions already have been held to be unconstitutional by the Supreme Court. The constitutional problem with such distinctions is that, while the Congress intended to provide benefits only to dependents, it presumed that women are dependent while requiring men to prove dependency. Since the presumption that women are usually dependent no longer accords with actual facts, the distinction has ceased to be constitutionally defensible. See. *e.g., Califano* v. *Goldfarb*, ______ U.S. ______. 45 U.S.L.W. 4237. 4241–4242 (1977) ; *Weinberger* v. *Wiesenfeld*, 420 U.S. 636, 643–

644 (1975). Despite the fact that the Congress intended to pay the benefits only to dependents, however, the judicial remedy has been to strike the dependency test for males and require the payment of benefits to both sexes without proof of dependency.

Title III of the bill submitted by HEW would fulfill the original congressional intent by requiring both sexes to prove dependency where the statute now requires such proof by males, and to eliminate other gender-based distinctions by equalizing the circumstances under which benefits are paid to the two sexes. The railroads agree that that should be done, but unfortunately the proposed amendments to the Social Security Act would not eliminate similar gender-based distinctions in the Railroad Retirement Act even with respect to Tier I benefits. The Railroad Retirement Act independently specifies (in Section 2) the eligibility requirements for benefits payable under that Act, which requirements apply to both Tier I and Tier II benefits.

We have pointed out that the benefits as to which gender-based distinctions are made were introduced into the railroad retirement systems by 1946 and 1951 amendments which were patterned after, and justified by, similar provisions that previously had been added to the Social Security Act. One of those distinctions already has been held unconstitutional by the Supreme Court. *Kaline* v. *Railroad Retirement Board*, ______ U.S. ______, 45 U.S.L.W. 3752 (1977), affirming *per curiam* the decision of the Sixth Circuit in that case, 541 F.2d 1204 (1976). Even apart from other considerations, therefore, it seems apparent that those distinctions should be eliminated along with the similar distinctions in the Social Security Act. Otherwise, benefits will be payable to a class of beneficiaries—non-dependent males and females—which was not intended either by the railroads and railroad unions or by the Congress. And, such non-depndents necessarily have other sources of income.

Moreover, if that is not done and the railroad retirement system is required by judicial decisions to pay benefits to both sexes without proof of dependency in circumstances where, by reason of the pending legislation, the social security system requires both sexes to prove dependency, the result will be very costly. Since benefits would be payable in circumstances where they would not be payable if the railroads and their employees were a part of the social security system, the railroad retirement account would not be reimbursed under the financial interchange for the Tier I portion of those benefits, and the entire cost would have to be paid out of Tier II taxes. While we do not yet have firm figures, Railroad Retirement Board actuaries have estimated that the actuarial deficit in the railroad retirement account would be increased substantially. On the other hand, if the gender-based distinctions in the Railroad Retirement Act should be eliminated in accordance with the approach proposed in the pending legislation in regard to the Social Security Act, the actuarial deficit in the railroad retirement account would be reduced substantially.

There are four gender-based distinctions in the Railroad Retirement Act. Under Section 2(c)(3)(ii), 45 U.S.C. § 231a(c)(3)(ii), a husband of an employee must prove dependency in order to be eligible for a spouse benefit, while such proof is not required of a wife of an employee. Under Section 2(c)(1)(ii), 45 U.S.C. § 231a(c)(1)(ii), a wife who has the care of a dependent child may be eligible for a spouse benefit, but no benefit is provided for a husband who has the care of a dependent child. Under Section 2(d)(1)(i), 45 U.S.C. § 231a(d)(1)(i), a widower of a deceased employee must prove dependency to be eligible for a survivor's benefit, while such proof is not required of the widow of a deceased employee. And, under Section 2(d)(1)(ii), 45 U.S.C. § 231a(d)(1)(ii), a widow who has the care of a dependent child may be eligible for a survivor's benefit, but no benefit is provided for a widower who has the care of a dependent child.

Attached as Appendix C hereto is a proposed Title IV to be added to the pending legislation. Section 402 would amend the Railroad Retirement Act of 1974 so as to eliminate the two gender-based distinctions in regard to spouse benefits, and Section 403 would amend that Act so as to eliminate the two gender-based distinctions as to survivor benefits. With regard to the spouse and survivor benefits as to which the husband or widower is now required to prove dependency, but the wife or widow is not, both sexes would be required to prove dependency as HEW has proposed in regard to the comparable benefits under the Social Security Act. A dependency test, which is identical in sub-

stance to that proposed by HEW, is set forth in Section 404. With regard to the spouse and survivor benefits now afforded only to a wife or widow having the care of a dependent child, such benefits also would be afforded to a husband or widower having the care of a dependent child, just as HEW would afford comparable benefits to both sexes under the Social Security Act.

We note that under Section 407 those amendments would be made effective with respect to benefits payable after December 31, 1977. This is because the railroads and unions, in agreeing to propose the legislation enacted as the Railroad Retirement Act of 1974, also agreed that they would not propose or support future changes in that Act which would be effective before January 1, 1978. Section 407 also provides that the amendments would not affect those who are already receiving benefits under the existing provisions of the Act, and those who applied for such benefits prior to the enactment of the proposed legislation also would be subject to the existing requirements.

ADJUSTING THE FINANCIAL INTERCHANGE

The financial interchange between the railroad retirement and social security system is now made on a delayed basis. As a result, there is an 18-month lag in the transmittal to the railroad retirement account of monies to which it is entitled under the financial interchange. While interest is paid by the social security trust funds for the period in which they hold those monies, so that this delay does not significantly affect the actuarial deficit in the railroad retirement account, the delay is very significant with regard to the cash flow in that account and therefore with regard to the actuarial estimate as to when the account will be exhausted. Railroad Retirement Board actuaries have indicated that placing the financial interchange on an accrual or current basis will delay the estimated time at which the account will run out of money by about two years, from 1986 to 1988. On the other hand, the effect upon the cash flow in the social security trust funds would be relatively insignificant, because of the much larger volume of monies that flow through those accounts. Placing the financial interchange on a current basis would not advance the date on which such funds would run out of money by more than a few days.

The bill proposed by the railroads and unions to restructure the railroad retirement system contained a provision which would have placed the financial interchange on a current basis, but that provision was not contained in the Railroad Retirement Act of 1974 as enacted by the Congress. The House Committee on Interstate and Foreign Commerce explained that provision and the reason for its elimination as follows (H. Rept. No. 93–1345, *supra* at 25:

"Under the present law, funds are transferred each year between the railroad retirement program and the social security program so as to place the social security trust funds in the same position they would have been had railroad service been covered employment under the social security program. . . . In practice, the net transfer is from the social security program to the railroad program. These transfers are made on a delayed basis about 18 months after the railroad annuities and survivor benefits have been paid and include an amount to make up for the interest earnings that have been lost to the railroad fund as a result of the delay in payment.

"As introduced, H.R. 15301 would have modified the provision so that starting with fiscal year 1976 the transfers would have been made each month on a current estimated basis. In the course of the committee's consideration of the bill, representatives of the Social Security Administration informed the committee that while they had no objection in principle to the change proposed, it would come at an inopportune time. The current estimates of the costs of the social security cash benefits programs . . . indicate a close balance of income and outgo over the next few years and a significant long-range actuarial deficiency. As a result changes in social security financing will be needed. It is anticipated that following studies by the current Advisory Council on Social Security, recommendations for changes in the financing of the social security program will be sent to the Congress.

"In recognition of the financial problems associated with the social security program, the committee has substituted for the provisions of the bill the provisions of present law which permit the transfers to be made on a delayed basis. It is anticipated, however, that further consideration will be given to a

change of this nature after the Congress has had the opportunity to consider changes in the financing of the social security cash benefits program."

The Report of the Senate Committee on Labor and Public Welfare made the same explanation. S. Rept. No. 93–1163, *supra* at 25. Hence, the proposal to place the financial interchange on a current basis was not dropped because of some perceived lack of merit. Indeed, the Social Security Administration "had no objection in principle to the change proposed . . . ." The proposal was dropped at the time because proposals to change the financing of the social security system to meet that system's financial problems were anticipated, and adjustment of the financial interchange could be considered more opportunely in connection with such changes.

Of course, the Congress is now considering changes in the financing of the social security trust funds, in connection with the bill proposed by HEW, so as to place the social security system on a sound financial basis. This appears to be the appropriate time, therefore, in which also to consider placing the financial interchange on a current basis. Section 405 of the Title IV which we propose be added to the bill (Appendix C hereto) would amend Section 7(c)(2) of the Railroad Retirement Act of 1974, 45 U.S.C. § 231f(c)(2), to accomplish that result. As so amended, that provision would read as it would have read if the joint railroad-union proposal for adjusting the financial interchange had not been dropped when the 1974 Act was enacted. Section 407 would make that adjustment effective with the fiscal year commencing October 1, 1978.

There can hardly be any doubts about the merits of this proposal. The money in question belongs to the railroad retirement account, and there is no justification for in effect requiring that account to make a forced loan to the social security trust funds for some 18 months. This is particularly so since those monies are very important to the cash flow of the railroad retirement account, while they are relatively insignificant to the much larger social security trust funds. Hence, the railroads urge that the financial interchange now be placed on a current basis by adoption of the amendment that we have proposed.

CONCLUSION

We realize that the financial problems of the social security system are serious, and that solution of those problems is difficult. Several aspects of the legislation proposed by HEW are commendable, but in our view sufficient consideration has not been given to the problems of the railroads and to the effects of the proposed legislation upon the railroad retirement system. We have attempted to describe the resulting deficiencies in the proposed legislation, and to suggest revisions or additions thereto that would provide a remedy. If those suggestions are adopted by the Congress, the legislation will provide a fairer and more equitable tax burden and will preserve the relationship between the railroad retirement and social security systems which the Congress intended, when it revised the Railroad Retirement Tax Act in 1973, so as clearly to establish a two tier system of railroad retirement taxes and benefits: the first tier providing for taxes and benefits that are geared to social security taxes and benefits and the second tier providing for those taxes and benefits that are in excess of those provided by social security and which in essence constitute a company pension plan for the railroad industry.

On behalf of the railroads which we represent, we want to express our appreciation to the Committee for affording us this opportunity to state the railroads' position in regard to legislation that is of large importance to the railroad industry as well as to many others. We urge, on behalf of those railroads, that the legislation be revised in the manner which we have suggested. This concludes our remarks, subject to any questions you may have.

APPENDIX A

RAILROADS' PROPOSED REVISION OF SECTION 103 OF S. 1902
(*Added language is in italic; deleted language is bracketed*)

APPLICATION OF EMPLOYER EXCISE TAX TO WAGES IN EXCESS OF CONTRIBUTION AND BENEFIT BASE

Section 103. (a) Section 230(c) is amended by adding at the end the following sentence: "For purposes of the employer tax liability under section 3111 of

the Internal Revenue Code of 1954 and section 3221(*b*) in the case of railroad employment, the contribution and benefit base referred to in paragraph (1) of section 3121(a) of the Internal Revenue Code of 1954 is deemed to be $23,400 and $37,500 with respect to remuneration paid during calendar years 1979 and 1980, respectively."

(b)(1) Sections 3111(a) and 3111(b) of the Internal Revenue Code of 1954 are each amended by inserting ", but without regard to paragraph (1) thereof" after "as defined in section 3121(a)".

(2) Section 3221[a](*b*) of the Code is amended by inserting [", but without regard to paragraph (1) of section 3121(a)," after "as defined in section 3121" each time it appears.] *at the end the following sentence: "For purposes of the additional rate of tax imposed by this subsection, paragraph (1) of the definition of 'wages' in section 3121(a) shall be disregarded."*

(3) Section 3121(a) of the Code is amended by inserting immediately after the number of designating paragraph (1) the following: "other than for purposes of sections 3111 and 3221*(b)*".

(4) This subsection is effective with respect to remuneration paid in any calendar year after 1980.

Appendix B

Railroads' Proposed Revision of Section 102 of S. 1902
(Added language is in italic)

Contributions from the General Fund of the Treasury to the Federal Old-Age and Survivors, Disability, and Hospital Insurance Trust Funds, *and the Railroad Retirement Account*, for Years of Exceptionally High Unemployment

Sec. 102. Section 201 is amended by adding at the end the following new subsection:

"(j)(1) On or before July 1 of each calendar year immediately succeeding a calendar year in which the average rate of unemployment, as determined by the Bureau of Labor Statistics of the Department of Labor, has exceeded 6 percent, the Secretary of the Treasury shall transfer to the Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund, and (as established by section 1817(a)) the Federal Hospital Insurance Trust Fund, *and as established by section 15(a) of the Railroad Retirement Act of 1974) the Railroad Retirement Account*, an amount computed in accordance with paragraph (2), and apportioned among the Funds *and Account in* accordance with paragraph (3), *subject to the provisions of paragraph (4).*

"(2) *Subject to paragraph (4)*, the amount to be transferred under paragraph (1) in a calendar year shall be the product of—

"(A) an amount equal to the sum of (i) the amounts appropriated in the preceding calendar year to the Federal Old-Age and Survivors Insurance Trust Fund under subsection (a), the Federal Disability Insurance Trust Fund under subsection (b), and the Federal Hospital Insurance Trust Fund under section 1817(a); and (ii) the amounts deposited in those Trust Funds in the preceding calendar year under section 218(h); and *(iii) the amounts appropriated in the preceding calendar year to the Railroad Retirement Account under section 15(a) of the Railroad Retirement Act of 1974; and*

"(B) three times the number of whole [one-term] [1] *one-tenth* percentage points by which, for that preceding calendar year, the average rate of unemployment exceeded 6 percent, divided by 1000.

"(3) *Subject to paragraph (4)*, the sum allocated to each trust fund *or account* in any calendar year from the amount transferred under the preceding paragraph, shall bear the same proportion to the sum of (i) the amount transferred under that paragraph in that year as the amount appropriated to that trust fund *or account* by subsections (a) or (b) of this section, or subsection (a) of section 1817, *or subsection (a) of section 15 of the Railroad Retirement Act of 1974*, as may be applicable, and (ii) the amount deposited in that trust fund under section 218(h), bears to the entire amount appropriated by those subsections to those trust funds *and to that account* and deposited in those trust funds, under section 218(h), in the preceding calendar year.

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[1] This appears to be a typographical error in S. 1902 as printed.

"(4) *In determining for purposes of this subsection the amount appropriated in a calendar year to the Railroad Retirement Account under section 15(a) of the Railroad Retirement Act of 1974, the actual amount so appropriated shall be reduced by an amount equal to the amounts covered into the Treasury (minus refunds) during such calendar year under section 3221(a) of the Internal Revenue Code of 1954.*

"*(5)* This subsection is deemed to become effective January 1, 1976. Any transfer under this subsection that would thereby have been made in calendar years 1976 or 1977, with respect to the rate of unemployment in calendar years 1975 or 1976, respectively, shall be made in three equal installments, the first within 30 days after the enactment of this subsection, the second no later than June 30, 1979, and the third no later than June 30, 1980. No transfer may be made under this subsection with respect to the rate of unemployment for any calendar year after 1982."

Appendix C

Railroads' Proposed New Title IV To Be Added To S. 1902

TITLE IV—AMENDMENTS OF THE RAILROAD RETIREMENT ACT OF 1974

SHORT TITLE OF TITLE IV

Sec. 401. This title may be cited as the "Railroad Retirement Equal Rights and Financial Interchange Amendments of 1977".

SPOUSE BENEFITS

Sec. 402. (a) Section 2(c)(1)(ii) is amended by deleting "in the case of a wife,"; by changing "her care" to read "his or her care"; and by changing "(individually or jointly with her husband)" to read "(individually or jointly with his wife or her husband)".

(b) Section 2(c)(3) is amended by striking the last clause thereof and inserting in lieu thereof "and (ii) was dependent upon such annuitant, as defined in subsection (i)."

SURVIVOR BENEFITS

Sec. 403. (a) Section 2(d)(1)(i) is amended by striking the material appearing after "subdivision (2)," and by substituting in lieu thereof "and who was dependent upon the deceased employee, as defined in subsection (i);"

(b) Section 2(d)(1)(ii) is amended by inserting "or widower (as defined in section 216(g) and (k) of the Social Security Act)" immediately before "of such a deceased employee"; by changing "her care" to read "her or his care"; and by changing the semi-colon at the end to a comma and inserting thereafter "and (C) was dependent upon the deceased employee, as defined in subsection (i);"

(c) Section 2(d)(2) is amended by inserting "or widower" after "widow" each time it appears in clause (B); and by changing "she" to read "she or he" in clause (B).

DEPENDENCY OF A SPOUSE

Sec. 404. Section 2 is amended by adding at the end thereof the following new subsection:

"(i) For purposes of sections 2(c)(3) and 2(d)(1)(i) and (ii), a person was dependent upon the individual—"such annuitant" or "the deceased employee"—referred to in such section (1) if such person's income (as defined in regulations of the Board) was less than such individual's income (as defined the month such individual became entitled to an annuity under subsection a(1), or, if such individual had a period of disability which did not end prior to the month in which he or she became so entitled, the month such period began or the month he or she became so entitled, or (B) in the case of such a person who survives such an individual, the month specified in subparagraph (A) of this paragraph or the month of such individual's death or, if such individual had a period of disability which did not end prior to the month in which he or she died, the month such period began or the month of his or her death,

and (2) such person files proof of such dependency (according to regulations of the Board) within two years after the applicable month specified in paragraph (1) of this subsection. In the case of a person who marries an individual in the applicable 3–year period specified in the preceding sentence, such period shall instead be from the date of such marriage to the end of such 3–year period."

FINANCIAL INTERCHANGE

Sec. 405. Section 7(c)(2) is amended (a) by striking the first clause of the first sentence and inserting in lieu thereof "Prior to the close of the fiscal year ending September 30, 1978,"; (b) by inserting after "would" and before "place" in the first sentence", as of the end of each month of the following fiscal year,"; and (c) by striking the second, third, fourth and fifth sentences and inserting in lieu thereof the following: "Such determination with respect to each Trust Fund shall be made, on an estimated basis subject to later adjustment (on the basis of actual experience), by the close of the fiscal year ending prior to the fiscal year to which it relates. If for any month any amount is to be added to any such Trust Fund, the Board shall, within ten days after the end of the month, certify such amount to the Secretary of the Treasury for transfer from the Railroad Retirement Account to such Trust Fund. If for any month any amount is to be subtracted from any such Trust Fund, the Secretary of Health, Education, and Welfare shall, within ten days after the end of the month, certify such amount to the Secretary of the Treasury for transfer from such Trust Fund to the Railroad Retirement Account. Any amount so certified shall further include interest (at the rate determined in subdivision (3) for the month under consideration) payable from the close of each month until the date of certification."

Sec. 406. Section 7(c)(3) is amended (a) by striking "for any fiscal year," and inserting in lieu thereof "for any month,"; and (b) by striking "computed as of May 31 preceding the close of such fiscal year," and inserting in lieu thereof "computed as of the end of the month preceding the close of such month,".

EFFECTIVE DATES

Sec. 407. The amendments made by sections 402 through 404 of this title shall become effective with respect to benefits under the Railroad Retirement Act of 1974 for months following December 31, 1977, except that such amendments shall not apply to an individual who receives benefits under sections 2(c) or 2(d) of that Act for the month prior to January 1, 1978, or who has applied for benefits under sections 2(c) or 2(d) of that Act prior to the date of enactment of this Act, until such time as he or she is not entitled to any such benefits under such sections for a month. The amendments made by sections 405 and 406 of this title shall become effective with respect to the fiscal year commencing October 1, 1978 and each succeeding fisal year.

POSITION OF THE RAILROADS REGARDING S. 1902

The taxes imposed and the benefits paid by the railroad retirement system have been divided by the Congress into two tiers: those that are equivalent to social security benefits and taxes (Tier I) and those that are in excess of social security benefits and taxes (Tier II). Tier I benefits and taxes are adjusted automatically in accordance with adjustments in social security benefits and taxes, while Tier II constitutes in essence a supplemental pension plan for the railroad industry alone with recommended future changes being primarily a matter for collective bargaining.

Maximum taxable wages.—The railroads urge that no change be made in the maximum taxable wage bases provided by existing law and that, if any changes are made, they apply equally to employers and employees. In any event, Section 103 of S. 1902 is defective because, as drafted, it would apply to Tier II railroad retirement taxes. The railroads propose an amendment (Appendix A) which would correct that defect. Tier II taxes have no relation to social security taxes or to the financing of the social security system, and Tier II finances and benefits primarily are a matter for collective bargaining (which is now in progress).

Contributions from General Treasury.—The proposal for contributions from the General Treasury to the social security trust funds in times of high unemployment (Section 103 of S. 1902) has a defect, believed to be unintended, which would result in a part of those contributions being made from the railroad retirement account and thus from taxes paid by the railroads. The railroads propose an amendment (Appendix B) which would correct that defect. Although funds would be contributed to the railroad retirement account under the proposed amendment, they would be credited through the financial interchange between the railroad retirement and social security systems to the social security trust funds. Hence, the railroad retirement account would not be advantaged, but also would not be penalized.

Indexing of benefits.—The railroads support Title II of S. 1902. It would correct a defect in the Social Security Act under which automatic adjustments of benefits exceed the rate of inflation, and thus go further than was intended. Since Tier I railroad retirement benefits are adjusted automatically in line with adjustments of social security benefits, the correction of this defect also would extend to those Tier I benefits.

Elimination of gender-based distinctions.—The railroads support elimination of distinctions based upon sex or gender, including the provision of dependency tests for both sexes where appropriate to carry out the original congressional intent. But while Title III of S. 1902 would do that in regard to the Social Security Act, it would not eliminate such distinctions in the Railroad Retirement Act. This requires amendment of the Railroad Retirement Act which independently specifies the eligibility requirements for both Tier I and Tier II benefits. The railroads urge that such an amendment be made, but note that jurisdiction of the House Interstate and Foreign Commerce Committee may be involved.

Adjustment of the financial interchange.—The railroads also urge that the financial interchange between the railroad retirement and social security systems be placed on a current basis, so as to eliminate the present delay of almost 18 months in the payment by the social security trust fund of monies which belong to the railroad retirement account. That delay has a serious adverse effect upon the cash flow in the railroad retirement account. Placing the financial interchange on a current basis requires amendment of the Railroad Retirement Act, and thus also may involve the jurisdiction of House Interstate and Foreign Commerce Committee.

Appendix A

Railroads' Proposed Revision of Section 103 of S. 1902
(*Added language is in italic; deleted language is bracketed*)

APPLICATION OF EMPLOYER EXCISE TAX TO WAGES IN EXCESS OF CONTRIBUTION AND BENEFIT BASE

Section 103. (a) Section 230(c) is amended by adding at the end the following sentence: "For purposes of the employer tax liability under section 3111 of the Internal Revenue Code of 1954 and section 3221(*b*) in the case of railroad employment, the contribution and benefit base referred to in paragraph (1) of section 3121(a) of the Internal Revenue Code of 1954 is deemed to be $23,400 and $37,500 with respect to remuneration paid during calendar years 1979 and 1980, respectively."

(b)(1) Sections 3111(a) and 3111(b) of the Internal Revenue Code of 1954 are each amended by inserting ", but without regard to paragraph (1) thereof" after "as defined in section 3121(a)".

(2) Section 3221[a](b) of the Code is amended by inserting [", but without regard to paragraph (1) of section 3121(a)," after "as defined in section 3121" each time it appears.] *at the end the following sentence: "For purposes of the additional rate of tax imposed by this subsection, paragraph (1) of the definition of 'wages' in section 3121(a) shall be disregarded."*

(3) Section 3121(a) of the Code is amended by inserting immediately after the number of designating paragraph (1) the following: "other than for purposes of sections 3111 and 3221*(b)*".

(4) This subsection is effective with respect to remuneration paid in any calendar year after 1980.

Appendix B

Railroads' Proposed Revision of Section 102 of S. 1902
(Added language is in italic)

Contributions from the General Fund of the Treasury to the Federal Old-Age and Survivors, Disability, and Hospital Insurance Trust Funds, *and the Railroad Retirement Account*, for Years of Exceptionally High Unemployment

Sec. 102. Section 201 is amended by adding at the end the following new subsection:

"(j) (1) On or before July 1 of each calendar year immediately succeeding a calendar year in which the average rate of unemployment, as determined by the Bureau of Labor Statistics of the Department of Labor, has exceeded 6 percent, the Secretary of the Treasury shall transfer to the Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund, and (as established by section 1817(a)) the Federal Hospital Insurance Trust Fund, *and as established by section 15(a) of the Railroad Retirement Act of 1974) the Railroad Retirement Account*, an amount computed in accordance with paragraph (2), and apportioned among the Funds *and Account in* accordance with paragraph (3), *subject to the provisions of paragraph (4).*

"(2) *Subject to paragraph (4)*, the amount to be transferred under paragraph (1) in a calendar year shall be the product of—

"(A) an amount equal to the sum of (i) the amounts appropriated in the preceding calendar year to the Federal Old-Age and Survivors Insurance Trust Fund under subsection (a), the Federal Disability Insurance Trust Fund under subsection (b), and the Federal Hospital Insurance Trust Fund under section 1817(a); and (ii) the amounts deposited in those Trust Funds in the preceding calendar year under section 218(h); and *(iii) the amounts appropriated in the preceding calendar year to the Railroad Retirement Account under section 15(a) of the Railroad Retirement Act of 1974; and*

"(B) three times the number of whole [one-term] [1] *one-tenth* percentage points by which, for that preceding calendar year, the average rate of unemployment exceeded 6 percent, divided by 1000.

"(3) *Subject to paragraph (4)*, the sum allocated to each trust fund *or account* in any calendar year from the amount transferred under the preceding paragraph, shall bear the same proportion to the sum of (i) the amount transferred under that paragraph in that year as the amount appropriated to that trust fund *or account* by subsections (a) or (b) of this section, or subsection (a) of section 1817, *or subsection (a) of section 15 of the Railroad Retirement Act of 1974*, as may be applicable, and (ii) the amount deposited in that trust fund under section 218(h), bears to the entire amount appropriated by those subsections to those trust funds *and to that account* and deposited in those trust funds, under section 218(h), in the preceding calendar year.

"(4) *In determining for purposes of this subsection the amount appropriated in a calendar year to the Railroad Retirement Account under section 15(a) of the Railroad Retirement Act of 1974, the actual amount so appropriated shall be reduced by an amount equal to the amounts covered into the Treasury (minus refunds) during such calendar year under section 3221(a) of the Internal Revenue Code of 1954.*

"*(5)* This subsection is deemed to become effective January 1, 1976. Any transfer under this subsection that would thereby have been made in calendar years 1976 or 1977, with respect to the rate of unemployment in calendar years 1975 or 1976, respectively, shall be made in three equal installments, the first within 30 days after the enactment of this subsection, the second no later than June 30, 1979, and the third no later than June 30, 1980. No transfer may be made under this subsection with respect to the rate of unemployment for any calendar year after 1982."

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[1] This appears to be a typographical error in S. 1902 as printed.

MACHINERY AND ALLIED PRODUCTS INSTITUTE,
Washington, D.C., June 23, 1977.

Hon. GAYLORD NELSON, *Chairman,*
Subcommittee on Social Security of the Senate Committee on Finance,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR NELSON: The Machinery and Allied Products Institute welcomes this opportunity to express its views regarding the Administration's social security proposals to solve the short- and long-run financial problems of the system. The Institute's membership is vitally concerned with the issues and believes a thorough review of the problems to be of critical national importance.

Before proceeding to an examination of some of the key issues, two general observations are in order. First, as representatives of the capital goods and allied product industries, we have always taken what we feel has been understandable pride in the leadership role played by the manufacturing sector of the economy in the establishment and development of the private pension plan system. As our statement brings out more fully, we believe only a vigorous and imaginative effort on the part of industry and government can achieve the goal of the proper growth and development of the private and public systems, both of which are vital to our present approach of providing for the needs of the older population of this nation. We think the most careful scrutiny of the interaction between social security and the private pension system is long overdue[1] and we approach the financing issues before this Subcommittee with this in mind.

Second, social security is and should continue to be an independent program. However, its financial impact cannot be reviewed in a vacuum. Social security financing must be considered together with all other tax recommendations of the Administration and Congress. The most notable examples are, of course, the tax provisions of the Administration's energy program now before Congress and the "tax reform" package to be submitted presently. Not to do so would be irresponsible because of the severe impact of social security taxes.

A summary of our position

The Administration has proposed an eight-point program designed to provide both short- and long-run financial solutions to the social security system. We urge that Congress review social security financing as a part of the total tax picture including all other tax recommendations so that the full impact of the program becomes clear. Specifically, we recommend that Congress take the following steps to alleviate the financial problems of social security:

1. Amend the Act to permit borrowing among the funds and borrowing from general revenues on an emergency basis with the proviso that there be an unqualified obligation to repay these funds.
2. Elimination of the "progressivity" of the current benefit formula; overhaul the spouse's benefit provisions; and remove the minimum benefit.
3. Add an "annual earnings" test to determine entitlement to retirement benefits.
4. Move toward establishment of universal coverage of the system.
5. Reform and improve the administration of the preretirement and disability programs.
6. Change the retirement ages, with regular retirement set at age 68 and "early" retirement at age 65.
7. Enact a tax rate increase of 0.5 percent for employers and employees each in 1978.
8. Provide realistic statutory "integration" rules for private plans, including the adoption of incentives to encourage the growth of the private system.
9. Increase the tax rate on the self-employed from 7 percent to 7½ percent.
10. Change the test of whether an individual may claim benefits as a dependent.
11. "Decouple" the social security benefit formula to eliminate the overadjustment for inflation now in the law.

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[1] *Social Security—The "Financial Crisis" in Perspective,* Machinery and Allied Products Institute, March 1977. (A copy of this pamphlet is attached.)

12. Advance the 1 percent increase in the OASDI tax rate which is scheduled to go into effect in 2011.

We also urge the Subcommitte and Congress to *reject* the following solutions:

1. Provisions for a special "counter-cyclical" payment from general revenues.
2. Removal of the ceiling on the amount of an individual's wage or salary on which the employer pays social security taxes.
3. An increase in the amount of the wage base subject to the employee tax, *beyond* the automatic increases in the current law.
4. A shift of revenue from the HI Trust Fund to OASDI Trust Funds.

In brief, these views flow from the following convictions:

> Any action taken by the Congress should preserve the basic elements of the present system—mainly, the concepts of the "relationship between the right to benefits and the performance of work."
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> Since the public system is not identical in scope, philosophy, or purpose with the private system and only a part of the population is covered by supplementary private pensions, it may not be possible to balance the two so as to provide perfectly complementary programs; however, Congress now has the opportunity in reviewing the financing solutions to take a giant step in this direction.
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> In selecting solutions, Congress must view the social security system in the full context of: the system's welfare aspects, its lack of universality, and the total tax burden carried by families and employers. In short, "band-aid" solutions can only worsen the long-run problems.

Our statement begins with a look at where the system is now and the identifiable problems. Following this, we review the Administration's proposals against the backdrop of the alternatives facing Congress. Finally, we conclude with some specific recommendations.

Some perspctive

The growth of the social security program in recent years has been staggering. Between 1966 and 1977 total benefit payments have risen from roughly $20 billion to over $90 billion, more than a 400 percent increase. Even after adjustment for inflation, benefit payments doubled in this decade.

In 1966, employers and employees paid a combined tax of 8.4 percent on the first $6,600 of wages; by 1976, the combined tax had increased to 11.7 percent of the first $15,300. Under present law, in 1978 the combined tax will jump to 12.1 percent on an anticipated maximum taxable wage base of $17,700. By 1978, the maximum tax levied on a covered worker will have climbed from $277 in 1966 to $1,070, about a fourfold increase.

The future tax picture is equally bleak. Even with the 1978 tax rate increase and anticipated annual increases in the maximum taxable wage base, the 1977 Trustees' Reports indicate the Disability Insurance Trust Fund will be exhausted in 1979, the Old-Age and Survivors Insurance Trust Fund in 1983, and the Hospital Insurance Trust Fund in the late 1980s. Thus, an even heavier tax burden seems inevitable to meet rapidly rising benefit payments now estimated to be over $150 billion by 1981.

There are, of course, only four sources for additional financing for the system. The first is an increase in the tax rates. A second approach is to increase the maximum taxable earnings base to a greater extent than the automatic-adjustment provisions would bring about. A third avenue is to inject a government subsidy into the social security system from the general revenues. The fourth approach is to cut benefits or benefit expectations.

The Administration has presented Congress with a package which to one degree or another employs all four of the methods of financing. Unfortunately, this kind of eclectic solution will bring with it a number of perversities for the system. To explain, we turn first to the introduction of significant general revenues to pay for the burgeonng costs.

General revenues—The abandonment of the "earned income" concept

The Administration has proposed that a "new counter-cyclical financing mechanism" be established to feed general revenues into the OASDI and HI Trust Funds. The basic concept is that an amount of money equal to the difference between payroll taxes that were actually paid and those that would have been collected for the year if unemployment had been no more than 6 percent would be transferred from general revenues to the social security trust funds.

Under the proposal, the transfers would cover the taxes that have been lost because of high levels of unemployment that began in 1975. While the transfers would actually be made in 1978, 1979, and 1980, they would reflect revenue shortfalls of the years 1975–78. The mechanism would be temporary, ending with the 1980 transfer unless renewed by Congress.

"*Earned income concept.*"—There are, of course, no excess general revenues available. Thus, this kind of federal revenue financing will hold up other new programs, including tax reduction, by extending the deficit. Frankly, once the funding from general revenues is started in any significant way, we doubt Congress will be able to stop the flow.

Further, the proposal raises a very fundamental question in connection with the future of social security financing. Simply put, of great importance to this system as it exists today are the relationship between benefits and earnings and the relationship between the right to benefits and the performance of work. The payroll tax is an essential part of the earned-benefit approach because this kind of contribution tax is more directly tied to employment than any other.

To expand on this issue, social security is best viewed as a device to force people to save during their working years to ensure adequate income in retirement. Within the lifetime framework, where taxes and benefits are considered jointly, the payroll tax is the appropriate method of financing a compulsory savings program.

Arguments to the contrary tend to dwell on the many non-wage related benefits of the system, such as the minimum benefit, the dependents' benefits, and the progressive benefit formula. Critics of the payroll system argue the system should be viewed as an expenditure program in an overall income maintenance system. Thus, the payroll tax would be evaluated in relation to other taxes, not to benefits.

Yet in so arguing for the introduction of general revenue financing, such proponents overlook, or at least underestimate, the following considerations:

1. The contributory financing payroll tax system allows workers to receive benefits as an earned right rather than as a dole.
2. A fixed source of income protects the system from the uncertainties of annual appropriations and, in the case of the Administration's proposals, the uncertainties as to economic projections regarding unemployment.
3. Indirect financing on the theory that social security is in significant part an income maintenance program begs the introduction of a means test because it is inefficient to provide income maintenance to those who do not need it.
4. General revenue financing—even if only in part—will place the system in competition with all other government programs for such funds.
5. Finally, the introduction of the concept (other than to finance benefits in special cases as is currently done) will inevitably lead to an increased reliance on such financing with accompanying pressure for increasing income taxes.

Overlooking the current "offsets."—At the present time, unemployment is heavily subsidized. The Administration would add to this subsidy by means of its "counter-cyclical financing mechanism" for social security. This approach, if adopted on a permanent basis, would bring with it a number of inconsistencies. For example, if during the course of a recession it were deemed appropriate to have a "stimulative" fiscal policy, this previously established policy would be counterproductive. It would tend to defeat the very purpose of an adequate reserve in the trust funds.

Beyond this, moving to general revenue financing overlooks the fact that Congress has already taken steps to ease the burden of low-income taxpayers and beneficiaries under the system. Specifically, the earned income credit introduced in 1975 goes a long way toward eliminating the burden of the payroll tax on the working poor. This is, of course, a limited device, i.e., the credit is extended only to taxpayers with children and provides no relief for low-income childless couples or single people. Its existence, however, coupled with the fact that the tax relief it provides occurs outside the social security system permits it to function as a strictly wage-related system and still be equitable.

As for low-income beneficiaries, Congress in 1972 created the supplemental security income (SSI) program to replace the old network of state programs providing for the needy aged, disabled, and blind. Under SSI, which is administered by the Social Security Administration and fully financed from general revenues, benefit levels, eligibility conditions, and means tests are uniform

nationwide. The SSI program is more than a revamping of existing public assistance programs; it is a federal minimum income guarantee serving as a floor for those on social security. Its very existence lessens the need for the welfare aspects of social security benefits, including the progressive benefit formula.

In sum, we already have committed significant general revenues to programs outside the social security system which are indeed completmentary to the system itself. To introduce general revenues in another way appears totally unnecessary and dangerous.

Trust fund levels

Another "virtue" of the countercyclical financing mechanism claimed by the Administration is that the necessary reserve level—presumably one able to withstand a serious recession—can be dropped from the desired 50 percent of annual outlays to 35 percent. At first blush, this is an appealing feature of this proposed financing mechanism.

On the other hand, it may be possible to drop the reserve below 50 percent to something around 35 percent without so drastic a step as the introduction of general revenue financing. Specifically, the law could be amended to permit borrowing among the funds. Thus, there need be no fear that the Disability Insurance Trust Fund would be exhausted in 1979 when it is evident that there are still adequate funds in the Old-Age and Survivors Insurance and Hospital Insurance Trust Funds. While this is not a long-run solution, it would provide needed flexibility and is in effect recommended by the Administration—at least on a one-time basis.

As to the argument that using general revenues averts the necessity of raising social security taxes during a recession, still another safeguard could be added to obviate that need. The law could be amended to provide that funds from general revenues could be loaned to the social security system in the event of a threatened depletion of funds. This could be established as an arm's-length transaction at prevailing interest rates. We make this suggestion with some trepidation because this type of financing could become a back-door to general revenue financing which we strongly oppose as set out above. This approach would give Congress still another option assuming the timing was wrong for a tax increase.

As to the absolute minimum level of reserves appropriate, a study should be conducted of our most recent recession experience. Most economists agree that the recession of 1973–75 was the worst since the depression of the '30s and that we are unlikely in the future to suffer any recession more severe. Looking at the 1977 OASDI Trustees' Report, it appears that the drop in assets on hand at the beginning of the year stated as a percentage of expenditures during the year was 36 percent from 1972 to 1976. Accordingly, a reserve of 40 percent would appear to be adequate to withstand another such recession, assuming, of course, that the structural defects currently in the system now aggravating the reserve run-off problem are corrected. At any rate, a full study might reveal that the levels of reserves previously thought to be necessary are not required in light of the actual 1973–75 recession experience.

Lowering Benfit Expectations—A Long-Run Solution

As the Administration points out, the current social security benefit structure requires immediate attention because the automatic price adjustments introduced in 1972 contain a flaw. Under the 1972 changes, whenever benefits for those already on the rolls are increased to keep pace with the cost of living, the wage replacement factors are increased by the same percentage. The purpose of this change is to assure that every future retiree who has the same average lifetime wage as a current retiree will receive the same benefit. The adjustment or indexing, however, fails to take into account the fact that average lifetime earnings covered by the system are also rising and, therefore, the benefit formula is actually overadjusted.

All appear agreed that a correction must be made and promptly. The Administration's proposal for correcting this flaw called "decoupling" is not altogether clear, but does include (1) a 45 percent fixed replacement formula; and (2) wage-indexing the earnings history.

Unfortunately, the Administration has not gone far enough in its "decoupling" proposal because decoupling in the broad view involves: the "progressivity" of the current benefit formula; spouse's benefits; and the minimum benefit. In short, Congress in approaching "decoupling" has the opportunity to reexamine in full the benefit promise under social security and whether it seizes upon the opportunity or not will implicitly or explicitly be establishing policy in these areas.

Eliminating "progressivity."—To explain, under virtually all "decoupling" approaches, the new system would have stable replacement rates and these rates will alter the pattern of benefits paid to future retirees. Thus, a first issue becomes how progressive should the benefit formula be. Currently the formula is structured so that the benefits of low-wage workers are a higher proportion of their preretirement earnings than those of high-wage workers. As part of a decoupling scheme, it would be possible to design a benefit formula that closely duplicates the existing structure. On the other hand, Congress could eliminate—or at least adjust—this progressivity which has evolved gradually over time.

With the existence of SSI, Congress should look at the alternative of providing proportional benefits to all retirees. This tack would separate the goals of earnings replacement and income maintenance into two programs. The earnings replacement function would be performed by social security—a strictly wage-related system—while the income support function would be transferred to SSI.

There would be many pluses to providing strictly proportional benefits to all retirees. Among these are the following:

1. The current progressive benefit structure carries with it a high cost and this cost—to the extent Congress deems it appropriate—could be transferred to general revenues within the structure of existing programs.

2. Social security benefits would be strictly related to past contributions and therefore appropriately financed by the payroll tax.

3. A proportional social security benefit approach would ensure that all future workers receive an equitable return on their contributions.

4. A proportional benefit structure would be more nearly parallel to the private system making "fair" integration with the public system more feasible and easier to administer. (It is the progressive nature of the current system that in large part makes it possible for lower paid employees to achieve a pension in excess of final earnings when the benefits of an unintegrated private plan and social security are combined.)

The spouse's benefit.—Another issue in terms of a future benefit structure is the benefits for aged spouses. Under the current program—designed on the basis of the presumed dependency of a married woman on the male head of the household—a number of inequities are created by the fact that the tax is levied on the individual but the benefit is awarded to the family. Specifically, a married worker receives an additional 50 percent of the primary benefit for the support of his spouse, raising his wage replacement rate and giving him more benefits for his payroll tax dollar.

Given a proportional benefit structure, it is probably easier to design a solution to the spouse's benefit inequity. For example, to maintain a 50 percent add-on, nonworking spouses might be given the option of contributing a "tax" equal to the tax for one-half of the income the spouse earns that is covered by social security.

At the same time, since more and more spouses are working, new averaging rules could be created. At the minimum, Congress should recognize that the issue goes beyond one of equitable treatment; the current spouse benefit is simply irrational under any kind of earned benefit system and in some respects is inefficient for an income maintenance system since it is typically the higher income workers who gain most under the current system.

Minimum benefits.—As with the case of the progressive benefit formula, the minimum benefit provisions under social security are at the heart of the progressive nature of the social security benefit scheme. It seems obvious that these benefits duplicate the SSI program and cannot be justified under an earned income benefit program. Beyond this, minimum benefits are a part of the problem called "double-dipping." Under the current system, workers entitled to other major pensions, such as federal civil service retirement benefits,

can easily achieve insured status under social security and receive at least the minimum benefit in addition to their regular pensions. In sum, in addressing "decoupling" attention should be given to the issue of minimum benefits as well.

The "technical" issues.—"Decoupling" is a long-term solution to the financing problems of the social security system. It is, however, far from being a simplistic cure because it requires resolution—as noted above—of a number of fundamental issues about the nature of the social security program. We would urge that each such issue be taken up by Congress and specifically dealt with.

Beyond the fundamental issues, "decoupling" also involves a number of technical decisions. Unfortunately, without the Administration's specific recommendations, it is not possible to comment in detail on the "hows" of decoupling. Suffice it to say that among the models presented in the past the most "saleable" appears to be the one proposed by the Ford Administration in June 1976.

This proposal would eliminate the indexing of the wage replacement formula by freezing the replacement factor for three categories of earners and replacing this adjustment by wage-indexing the earnings history. Under this approach, all prior-year wages would have the same comparative value as wages earned in the year before retirement. Once the initial benefit amount for an individual were determined, subsequent increases in the monthly benefit would depend on increases in the CPI, as in the present law. This approach would eliminate about half the long-term deficit.

There is also merit in the approach which would index the earnings history by price. Since prices over a long period of time have not risen as rapidly as wages, the relationship of benefits to final wages declines continuously over time. Thus, all other things being equal, price-indexing develops more savings, and it could be employed to eliminate the entire deficit by itself.

The problem, however, is that price-indexing would produce slowly declining replacement rates. Those who argue for price-indexing contend in this regard that adjustments can be made later by future Congresses whenever they believe it to be necessary. In our view, while we recognize the merits of price-indexing, it is less acceptable than wage-indexing because of the implied need for congressional action to periodically boost benefits. This latter situation might well carry us back to the pre-1972 days when Congress felt compelled to raise benefits before every election—or so it seemed.

Other technical problems that have to be wrestled with include:

1. The need for a transition period to phase-in the decoupled system. In our view, a transition period is obligatory.

2. Whether or not the lifetime earnings concept should be modified. We believe the lifetime earnings concept should be kept because it fits with a wage-related annuity program as the appropriate base on which to award benefits.

Concluding comment.—"Decoupling" is essential and Congress should move as rapidly as possible to accomplish this change. At the same time, it does raise fundamental questions regarding the system and it is equally important that Congress come to grips with these basic issues.

As we view decoupling, it presents Congress with an opportunity to put the system firmly on a wage-related track. If this is done, the Congress will have taken a giant stride toward making the private and public systems compatible. Once the two systems become more "synchronized," this should provide a needed incentive to the growth of private programs which in turn will lessen the pressure for expansion of the public system.

Other benefit decreases

Change in test for beneficiaries.—The Administration's proposal would narrow eligibility for dependent's benefits, limiting it to whichever spouse had the lower income over the preceding three-year period. This proposal is designed to mitigate against the Supreme Court decisions which in effect permit any husband to claim dependent's benefits, regardless of his actual previous dependency on his wife's earnings. We think this would be a meritorious change.

Other changes.—The Report of the Advisory Council on Social Security in March 1975 made a number of suggestions which should be reviewed during this current process. Among others, the Council suggested:

1. The provision of the retirement test under which a full benefit may be paid for any month in which a beneficiary earns less than one-twelfth of the annual exempt amount should be eliminated, and replaced with one based strictly on

annual earnings. This would eliminate payment of benefits to those persons who are able to channel their yearly earnings into a few months and establish benefit eligibility for the rest of the year.

2. The minimum benefit should be frozen at a specified level and benefits should not exceed 100 percent of the earnings on which the benefit is based. This is aimed at workers who are eligible for retirement benefits under both social security and other retirement programs (for noncovered employment). It is viewed as a windfall to those individuals because benefits they will receive are out of proportion to what they contribute.

In this regard, we have noted above that decoupling provides an opportunity to remove the minimum benefit altogether. The Advisory Council recommendation would appear to be a welcome interim step until the complete removal is accomplished.

3. Make universal coverage compulsory. This would expand coverage to those with earnings not now covered—mainly from public employment. It is the Council's view that such a change would eliminate unwarranted duplication of benefits. It would, of course, greatly improve the financing outlook, at least for the shorter run.

This proposal is of course fraught with difficulties, including legal restraints. On the other hand, it makes a lot of sense if viewed in the context of other changes which would move the system to a "pure" wage-related program. Once this is accomplished, it would be easier to design complementary state and federal programs if Congress deemed it appropriate to mandate universal coverage by social security.

Currently, "double-dipping" and state and local financial problems leading to withdrawal from the system place a considerable financial burden on the 90 percent of the population and their employers who must by law pay for social security. It would appear quite appropriate to move toward universal coverage and the logical starting point is with federal government employees both military and civilian.

Longer-run benefit solutions.—It is clear that in a major overhaul of the social security system, attention must also be directed to preretirement survivor and disability benefits and the appropriate retirement age. As to the former, it is obvious that the needs that survivor and disability benefits are designed to fill are basically different from those for retirement benefits. Thus, it is not necessarily appropriate to have identical benefit structures and formulas for these quite different situations.

Under existing law, there are situations where survivors and disability benefits greatly exceed retirement benefits for persons with similar earnings This is because earnings are averaged over a shorter and more recent period—when earnings are generally higher.

Decoupling may help eliminate this anomaly in part because past earnings would be indexed tending to bring all earnings "up to date."

In addition, there have clearly been cost problems associated with the administration of the disability program. Part of the needed reform is the necessary administrative changes so as to ensure the program provides payments to only those persons who are truly disabled in keeping with what the law now intends.

A longer-run solution related to the benefits discussion involves a change in the retirement age. While there would appear to be no "urgency" in terms of a need for congressional action, it is clear that projections show the proportion of retirees to workers increases greatly in the next century. In addition, other pertinent trends show an increasing physical capability of the aged to continue working. Putting the trends together, and in light of the forecast rise of the social security costs, an attractive option is to encourage later retirement by moving the normal retirement age forward, perhaps to age 68 and early retirement to 65.

Short-run financing solutions

When all is said and done about decoupling and benefit modifications, the system still has a short-run financing problem. If Congress rejects the Administration's proposal to adopt general revenue financing—as we have urged it should—the two basic approaches remaining are an increased tax rate and/or an increased taxable wage base. But first, a closer look at the financing problem is in order.

Short-run financing needs.—The 1977 Trustees' Report provides a "medium-range" cost estimate for the next 25 years (1977–2001). Independent of hospital insurance, the Report indicates that the old-age, survivors, and disability insurance system is estimated to be under-financed by 2.34 percent of taxable payroll under present law and by 2.06 percent of taxable payroll if the system is decoupled and the replacement ratios are stabilized. While it is useful to have 75-year forecasts, it would appear that Congress would be quite safe if it limited its 1977 correction to the shorter run which is about two percent of taxable payroll on an average for the next 25 years, assuming that prompt action will be taken to decouple the system.

Raising the taxable wage base.—Under the Administration's proposal, beginning in 1979 and in each alternate year through 1985, the amount of income subject to social security tax would be increased by $600, in addition to any increase that went into effect automatically, reflecting increases in the average wage.

While relatively limited, we believe raising the taxable wage base as a financing solution would be counterproductive. First, it seems obvious that arbitrary increases in the maximum taxable wage base are contrary to the goal which would be achieved by decoupling the system by indexing wages. The automatic adjustment system already reflects current changes in terms of the tax burden and wage indexing is a complementary approach to that for determining benefits. Using the wage base to raise needed revenues would simply "distort" what decoupling can accomplish.

Second, raising the wage base automatically generates higher social security benefits and thus represents increased financial obligations for the system. Indeed, a large percentage of the increased revenues accruing from the broadening of the wage base would eventually be paid out in benefits to the affected high-wage earners.

Third, among the other concerns are the following:

1. Expansion of the "savings" imposed on the higher-wage earners and their employers is likely to have a negative effect on private saving and adversely affect the availability of capital.

2. The higher social security benefits which would accompany a wage base increase diminish the role to be played by private pensions.

3. This kind of taxing which is clearly inefficient since it adds to the long-range costs of the system can only be justified on the grounds of income redistribution. If we are going to move to a wage-related system, it is theoretically the wrong kind of tax increase.

Taxing employers on the entire earnings of employees.—At present both the employer and employee pay social security tax only on the first $16,500 of the employee's earnings. This figure is projected to rise, in stages, to $23,400 by 1982 under current law. The Administration's proposal would eliminate the limit on the earnings on which employers pay social security taxes—the wage base—in three annual steps, starting in 1979. The base would be increased to $23,400 in 1979, to $37,500 in 1980, and to the entire amount of wage or salary paid in 1981. The estimated cost to employers is set at $30 billion over the next five years.

We are opposed to this financing innovation for a number of reasons. First, this approach is a giant step away from a stricter earnings-replacement scheme. For those who want to clearly establish social security as an income maintenance system, this taxing change is welcome because, as in the case of going to the general revenues, it would redistribute the tax burden on the so-called "ability to pay" basis. As we have noted earlier, we believe it would be a grave error to set an income maintenance goal for the social security system.

Second, this kind of tax will have an uneven impact. Labor intensive and "high pay" industries will be much harder hit than capital intensive and "low pay" industries. While from the capital goods section viewpoint this might spur in some measure the sale of labor saving equipment, it is bad policy in terms of the "fairness" of the tax.

Third, traditionally employers and employees have shared the cost of the social security system. Because of this, a number of offsetting benefits have been provided for employees. For example, the retirement benefit is tax free. While from time to time the case is made that this should be changed, this has been resisted in Congress largely because the worker's contribution of one-half

the "cost" was subject to tax when earned. If Congress changes the mix—and removing the lid on the taxable wage base for employers would likely be only a starter—it is logical also to change the tax rules for employees as well because they would be paying a smaller and smaller portion of the cost.

Fourth, coupled with this point are the findings that in countries with relatively high employer payroll taxes, employers tend to pay a basic wage that is lower by the amount of the tax. Thus, employees might be double losers and end up by paying the tax through cuts in pay increases and losing the tax-free advantage of social security.

In addition, if it is assumed that the incidence of the tax will largely be borne by the consumers through higher prices, then it is an inflationary taxing alternative as well.

Finally, it would appear that this kind of new tax would bring with it a number of administrative problems. Given the the complexities of compensation including the range of bonus and incentive programs and the trade-offs made between salary and incentive pay, a host of new rules would have to be promulgated to determine what this new tax was to be levied on. In short, the current employer-employee tax split has considerable merit in that it is relatively simple. Further, there are the broader considerations noted above.

Increasing the tax rate.—The Administration's proposal would provide increases in the tax rate on the self-employed and advance the planned OASD tax rate increase. As to the former, the tax rate on the self-employed would be increased from the present 7 percent to 7½ percent, starting in 1979. The rationale for this change is that it would restore the historical relationship between payments by the self-employed and the employed. We believe that restoring the self-employed rate to 75 percent of the combined rate for employees and employers is appropriate. We note that this change was recommended by the 1975 Advisory Council.

The second tax rate change proposed by the Administration would advance the planned OASDI tax rate increase from the year 2011 to 1985 and 1990. More fully, the tax increase for that year which amounts to 1 percent each on employer and employee would be moved forward. One quarter of the increase would be imposed by 1985 and the remaining three quarters in 1990. It is anticipated this proposal would reduce the long-term (75 years) taable payroll deficit of 8.2 by 0.6 percent of taxable payroll.

We believe that the proper financing solution for the short run lies in increasing the tax rate. It would appear that a tax rate increase of 0.5 percent for employers and employees each in 1978 coupled with the Administration's proposed increase in 1980 would be sufficient to solve the problem until at least the end of the century. One key factor which must be studied to determine the adequacy of this proposed tax hike is the future reserve level to be maintained. If we are correct, as discussed above, that the reserve can be lowered to a 40 percent, rather than the current 50 percent target, it could mean the 1.0 percent increase is more than sufficient. Further, the tax rate increase would have to be coupled with other reforms such as the higher rate for the self-employed, "decoupling," an elimination of as much of the progressive nature of the benefit structure as possible, and any other benefit reductions that are appropriate. We have, of course, discussed these issues in detail above.

As to the rate increase itself, it would be more acceptable when accompanied by the reforms which would make contributions more closely allied to subsequent benefits. On the other hand, it has merit standing alone. Specifically, a tax rate hike does not add to future costs of the system as is the case with the taxable wage base increase. In addition, with the advent of the earned income credit the additional tax on low-income families is less burdensome. It seems obvious that if the low-income workers, like all workers, are going to lay claim to earned benefits under the social security system that they should share a part of the increasing cost of the system.

This approach does not preclude Congress from recognizing the "regressive" nature of the tax rate and opting to provide broader relief under the earned income credit law.

In this connection, a May 19, 1977 staff study entitled "Economic Recovery and the Financing of Social Insurance" issued by the Senate Committee on the Budget points to a couple of specifics that might be employed to reduce

the economic impact of "heavy payroll taxation." Suggesting in effect that there must be an adequate flow of trust fund revenues which logically will mean a tax rate increase, the study suggests the use of tax credits for both employers and employees to moderate the impact of the social insurance taxes.

While we do not necessary advocate such tax credits, we do think it important to preserve the earned income aspects of the social security system and the best way to achieve this goal when financing is needed is an increase in the tax rate. As the study points out, we are now dealing with what we hope and have reason to believe is an extraordinary time in history, namely, the aftermath of a very "abnormal" recession—the worst of the post-war recessions. In this light, extraordinary financing solutions might appear in order but only if of an indirect character, because shifts such as the general revenue financing proposed by the Administration will tend to permanently shift the system towards an income maintenance system. One-time tax credits, a broadened earned income credit, and even higher benefits under SSI do not impact the social security program directly and therefore might be viewed as the proper escape valves.

Social security and private pensions

This Subcommittee is well aware of the so-called three-tiered system of retirement benefits. The first tier consists of welfare programs which provide a minimum guaranteed income to the needy elderly. The second is compulsory public contributory programs and the third is private provisions for retirement comprised of private pensions and individual saving.

We have discussed already the relationships between the first and second tier. It is equally important, we believe, to discuss the relationship of the second and third tiers as well.

One of the chief stumbling blocks to compatability between the public and private retirement systems has been the fact that only about half of the private sector is covered by private pension plans. It would appear in this connection that the Employee Retirement Income Security Act (ERISA) is currently adversely impacting the growth of private plans. While no data is available as to how many employers abandoned plans to install a pension plan because of ERISA, a Pension Benefit Guaranty Corporation (PBGC) study—Publication No. PBGC 505—shows that more than 10 percent of the plans estimated to be covered by termination insurance under Title IV of ERISA have been terminated during 1975–76. Indeed, terminations of single employer defined benefit plans in 1976 increased 84 percent over 1975, and in 1976 15 percent listed ERISA as the sole reason for termination.

It seems obvious that if the private sector is discouraged from providing pension benefits, the social security system will have to fill the gap. It thus would appear appropriate in the current review of the financing needs of the social security system to look once more at the role social security might play in providing incentives for the development of private plans. For example, it would be useful to review the following suggestions:

1. The possibility of an option for employers to establish or maintain a private plan and to deduct the contributions made for such a plan from social security taxes payable to government.

2. The creation of a two-layered social security system with employees covered by private plans given an option of making the full contribution to the optional portion of the public plan or riding with the private plan.

3. Making social security insurance above a certain level optional for all covered employees.

In sum, it appears essential that Congress consider the future growth of the private system while it reviews the public system. In this regard, it would be appropriate to review the growth of individual retirement accounts (IRAs) for workers not covered by a company or union plan. It would also be timely to review once again the rules on the integration of the private and public plans. Since integration is based on the logical notion that public and private retirement programs sholud function as a unified system, the steps taken by Congress to move the public system toward more comparability with the private approaches will, of course, simplify the integration issues.

It seems clear that the threat of the possible disallowance of integration which would significantly raise the cost of most private plans is now a major

disincentive to the establishment of a private plan. Perhaps it is time for a bold step by Congress in this regard. Specifically, Congress could establish the following three-pronged policy:

1. Adequate retirement income for low-wage workers is to be provided by a combination of social security and supplementary security income.
2. Middle-income workers can supplement their social security benefits through either private pension plans or individual retirement accounts.
3. High-income employees are not to receive large public benefits and a cap is to be put on the public system to both prevent windfall benefits for the higher-paid retirees and encourage private saving initiatives, including private plan coverage.

Adoption of this kind of policy would enable statutory rules on integration to be established. It would also make more feasible an integration scheme with public plans for federal, state and local workers.

To sum up, social adequacy is out of place in an earned income retirement system. Attempts to maintain an adequate retirement program and keep it in major part as an income maintenance system simply will force a host of perversities such as a staggering cost burden and a disincentive to the establishment of private plans. It is now timely to recognize that the public system cannot go on much longer as a hybrid system. Recognition of this reality will serve to direct Congress toward the major reforms which will more closely unify the three-tiered retirement system.

Recommendations in summary

The Administration has proposed an eight-point program designed to provide both short- and long-run financial solutions to the social security system. We urge the Subcommittee and Congress to *reject* the following solutions:

1. Provisions for a special "counter-cyclical" payment from general revenues.
2. Removal of the ceiling on the amount of an individual's wage or salary on which the employer pays social security taxes.
3. An increase in the amount of the wage base subject to the employee tax, *beyond* the automatic increases in the current law.
4. A shift of revenue from the HI Trust Fund to OASDI Trust Funds.

We do support the following proposals:

1. An increase in the tax rate on the self-employed from 7 percent to 7½ percent.
2. A change in the test of whether an individual may claim benefits as a dependent.
3. "Decoupling" of the social security benefit formula to eliminate the over-adjustment for inflation now in the law.
4. An advancement of the 1 percent increase in the OASDI tax rate which is scheduled to go into effect in 2011.

Beyond the Administration's proposal, we urge that Congress review social security financing as a part of the total tax picture including all other tax recommendations so that the full impact of the program becomes clear. Specifically, we recommend that Congress take the following steps to alleviate the financial problems of social security:

1. Amend the Act to permit borrowing among the funds and borrowing from general revenues on an emergency basis with the proviso that there be an unqualified obligation to repay these funds.
2. Eliminate the "progressivity" of the current benefit formula; overhaul the spouse's benefit provisions; and remove the minimum benefit.
3. Add an "annual earnings" test to determine entitlement to retirement benefits.
4. Move toward establishment of universal coverage of the system.
5. Reform and improve the administration of the preretirement and disability programs.
6. Change the retirement ages, with regular retirement set at age 68 and "early" retirement at age 65.
7. Enact a tax rate increase of 0.5 percent for employers and employees each in 1978.
8. Provide realistic statutory "integration" rules for private plans, including the adoption of incentives to encourage the growth of the private system.

Concluding comment

The social security system is now some 40 years old and it is very timely for a thorough congressional review of the role that social security can effectively play in the future. It is both not enough and unnecessary to push through crisis-type proposals.

As we see it, the system must be reshaped into a purer earned income replacement program. With the development of the SSI program and the earned income benefit program, Congress has created a floor of protection for low-income workers which can be developed to complement the earned benefit program without directly burdening the system.

It is in our view timely to recognize that, in the long run, the public system cannot be counted on to provide for all retirement needs. Steps taken to limit the program so as to encourage the growth of the private system and other private savings are appropriate.

While we understand the magnitude and difficulty of a complete review, we think the timing is now right. Given a redefined goal and policy direction, the social security program can very adequately fill the middle-tier of needs in retirement. In short, the more realistic goal is a return to the social security concepts of some 40 years ago. Unfortunately, the Administration's proposals would, in balance, tilt the system further toward a welfare or income maintenance program. In our opinion, this would be totally unsound.

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We appreciate this opportunity to express our views and if we can be of assistance to the Subcommittee in its challenging task of reviewing the Administration's proposals, please feel free to call upon us.

Respectfully,

CHARLES STEWART,
President,

Attachment.

SOCIAL SECURITY—THE "FINANCIAL CRISIS" IN PERSPECTIVE

Introduction

The growth of public and private institutions as a means of providing retirement income is one of the most important economic phenomena of this century. Starting at nearly ground zero, the pension system has mushroomed to such an extent that today over 90 percent of the entire work force is covered by the social security system or state and local government retirement programs, and approximately one-half of the employees in private, nonfarm business establishments are participants in private pension plans.

But what does the future hold? On the private side, it is probably fair to state that the future is uncertain. This is because of a combination of converging situations. First, the Employee's Retirement Income Security Act of 1974 (ERISA) has brought with it certain clearly identifiable cost burdens, and the threat of further government strait-jacketing of the entire private pension and welfare system.

Second, inflation is a problem. Given the likelihood of continued and significant inflation, the private pension system is challenged by a number of concerns, such as increased costs because of a decrease in the value of plan assets, the plight of the private plan retiree whose pension income is being rapidly eroded, and the impact that inflation will have on government requirements under ERISA and the social security system.

Finally, there is the social security system itself. Its future as a retirement program could well retard the growth of private pension plans.[1] Because it is not identical in scope, philosophy, or purposes to the private scheme, it has been impossible to date to balance the two so as to provide complementary programs. Absent universally mandated private benefits, we must face the reality that only a part of the population is covered by supplementary private pensions.

[1] For an earlier MAPI study on this issue, see "Social Security and Private Pensions at the Crossroads: Crisis or Compromise?" (MAPI, 1967).

But the same reality indicates that the future growth of the public system could by itself inhibit the growth of the private system since the costs of the two systems are in a major sense substitutes for current wages and salaries. For his reason, the private system has a major stake in the future of the public system. This study comments on what appears to be in the offing, both in the short-term and long-term for the social security system.

Short-Term

For several years, there has been widespread concern about the financial problems of the social security program (the cash benefits of the old-age, survivors, and disability system). The first official hint of this appeared in the 1974 Trustees Report. This report indicated, however, only that the major problems would occur some years hence, particularly after the turn of the century.

The 1975 Trustees Report brought worse news. Not only were there long-range problems, but because of the combined effects of inflation and unemployment, short-range cash-flow difficulties emerged. An ever gloomier picture was presented in the 1976 Trustees Report. (See Tables III and IV attached.) It was estimated that the Disability Insurance Trust Fund would be exhausted in 1979 under almost any circumstances. The Old-Age and Survivors Insurance Trust Fund was found to be somewhat better off—its exhaustion date was projected to be 1984.

Quite obviously, with so many beneficiaries depending upon this source of income—about 33 million at the present time—some corrective action must be taken by Congress and fairly soon. Congress, however, has been reluctant to act because of economic conditions and has opted to draw down the trust fund reserves on the theory that a tax increase would be counter-productive to the needs of our economy. But even under the more optimistic views, it is apparent that time is running out. Further, the longer Congress waits, the more drastic the cure becomes. Thus, most observers feel Congress will turn to this problem in the 95th Congress.

Additional financing alternatives.—Additional financing for the system can come from only three possible sources. The first is an increase in the tax rates. Along these lines, the then President Ford on January 4 proposed payroll tax rate increases beginning January 1, 1978.[2] In brief, the combined rate would increase gradually until 1981 when it would be 15.7 percent, about 1 percent higher than presently planned under the law. (See attached Tables I and II.)

tration, and recommendations to the Congress will be submitted shortly."

Resistance to this approach, i.e., total reliance on a tax rate hike, will come from those who believe an increase in the tax rate worsens the regressive nature of the payroll tax and could increase inflationary pressures in the short run. Proponents will argue, however, that the tax burden on low-income families should be viewed in the context of the total federal tax burden carried by such families and will point to the Earned Income Credit introduced in 1975 which provides direct cash payments to certain low-income taxpayers.

In addition to noting that this credit was designed with the social security tax burden in mind, proponents of this approach will explain that a tax rate hike is less perverse than other forms of adjustment which are possible.

Increasing the taxable wage base.—A second approach is to increase the maximum taxable earnings base to a greater extent than the automatic-adjustment provisions would bring about. Proponents of this approach argue that we still will be within the confines of the payroll tax structure if this is done and will shift the burden to higher wage earners. In this connection, it will be noted that for years the wage base was set at a figure representing the 90th percentile of wages and salaries, but that it is well below that now.

Opponents will argue this would place the increased cost burden on only the top 15 percent of the workers and their employers, and would limit the extent to which the private sector can provide economic security. In addition, it will be pointed out that a wage base increase is less efficient than a tax rate increase because it would create entitlement to higher benefits in the future. In fact, these future benefit costs would actually increase the long-range deficit.

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[2] President Carter in his budget message of February 22, 1977 "withdrew" the requested social security tax rate increases. The budget message notes: "Proposals to solve the social security financing problem are being carefully reviewed by this Adminis-

Using the general revenues.—A third approach is to inject a government subsidy into the social security system from the general revenues. Its proponents will argue that a very large part of the benefit commitment is not entirely wage-related, but also includes income redistribution from the richer to the poorer participants. Under these circumstances, it is claimed that it is inequitable to support such transfers of income with funds raised by regressive taxes, particularly when higher incomes derived from sources other than wages are not taxed. Opponents will argue the need to preserve the integrity of the present self-financing system and point out that recourse to general revenues will obfuscate upon whom the burden is really falling. In addition, once we rely on general revenue financing for a significant portion of the benefit cost, we may be forced to increase income taxes as a means of paying for the system.

Other solutions.—It is, of course, possible to have a combination of these three alternative methods of financing. Beyond that, Congress might opt for what could be termed a "wrinkle on the wrinkle," such as:

1. The introduction of a bracket system to provide higher tax rates for higher income workers a la the income tax system.
2. Removal of the ceiling on the employer's wage base.
3. Provision for a one-time grant from the general revenues and/or emergency borrowing authority from the general fund.
4. Simplification of the benefit formula designed to reduce the cost impact of "double dippers," e.g., government workers, state or federal, having limited covered employment but nonetheless qualifying for a "reasonable" social security retirement benefit. One suggestion for such simplification is to design a final average pay concept such as the 10 consecutive years of highest covered earnings with the benefit produced prorated if the employee has not been covered for at least 35 years.
5. Levy an income tax on one-half the benefits or make F.I.C.A. taxes deductible to the employee on his federal income tax, but in exchange, tax all benefits as income to accompany a shift of part of the financing to the general revenues.
6. Transfer certain of the social security benefits which are basically income transfers from high-wage earners to other public assistance systems paid for by the general revenues.

Although the crystal ball is fuzzy at this point, many observers believe that a combination of the three basic approaches will be adopted by Congress. As to timing, final action is expected to take place no later than early 1978.

A comment on the tax aspect.—There is a dilemma facing Congress regarding the financing needs of the social security system. As noted above, Congress must correct for the unexpected near-term shortfalls of income in order to prevent the trust funds from becoming totally depleted. It could, of course, change the benefit structure, but this alternative is at best remote in light of government's implied promises and the fact that financial plans are based, rightly or wrongly, on the stability of the program. It is when this option is ruled out that Congress faces a dilemma. On the one side, Congress is looking at a substantial "stimulation" package proposed by the Administration to ensure economic recovery which ironially includes—at least as proposed—an option for employers to take a credit against income taxes equal to 4 percent of social security payroll taxes and a $50 payment to every beneficiary of social security. On the other side, Congress must consider raising payroll taxes at least as one option to adequately finance the social security system, and this would increase the total federal tax burden carried by families and employers. If on the other hand, Congress relies on general revenue financing for a portion of the benefit cost for the wage-related OASDI system, it will eventually be forced to turn to increased income tax rates as part of the means for obtaining the income needed to provide benefits.

Compounding this dilemma for Congress is the fact that a host of costly benefit improvements in the system are gaining additional supporters. For example, there is an amendment proposed that would end the limitation on income which a person can earn after becoming a beneficiary following retirement. There are also the pending changes that would eliminate alleged sex discrimination in the benefit system. And so on.

In sum, it is no longer possible for Congress to look at social security without reviewing the entire federal tax picture. Further, absent variable social security benefits, it is not likely that social security tax increases will be synchronized with the general economic needs.[3]

Long-term

As noted earlier, it was pointed out in the Trustees Report of 1974 that the system has a long-term financing problem, and under the system, long-term is indeed that because the Trustees' forecasts cover 75 years, or until the year 2050. Under the 1976 Report, the magnitude of the problem is spelled out in a variety of ways. Most conservatively, the projection is for an actuarial deficit in the system of 7.76 percent of taxable payroll over the next 75 years. Stated in absolute terms, the deficit is $4.3 trillion, using an annual interest rate assumption of 6.6 percent. It has also been estimated that there is an unfunded accrued liability of about $700 billion—the present value of future benefits to 33 million beneficiaries, including benefits "earned" or accrued to taxpayers increases the liability to $3.1 trillion. All appear agreed that a large long-range deficit appears likely under current economic assumptions.

Causes of the long-term deficit.—Among the major causes of the long-term deficit in the social security system are the changed relationship between increases in prices and increases in wages, a basic flaw in the benefit formula, and changes in the fertility rate.

Increases in wages and prices.—In 1972 when Congress adopted the system of automatic benefit increases, i.e., increases in accordance with changes in the cost of living, it also proposed to pay for the benefit hikes by automatically raising the tax and benefit base in accordance with upward shifts in covered wages. The theory was that for the past twenty years wages had grown almost twice as fast as prices and if that relationship continued, tax revenues would automatically be produced sufficient to support the new benefit level.

Obviously, the projected trend has not materialized. Recently, prices have risen faster than wages and the Trustees in 1976 estimated that over the long term wages will rise at 5.75 percent per year and prices will rise at 4 percent. To avoid deficits if prices rise at 4 perent, wages would have to rise at a rate close to 8 percent per year. Should a higher rate of inflation than that projected become typical, the costs of the system could skyrocket because wages may not rise as fast as prices and clearly not twice as fast.

To date no one is talking about a solution to this problem, in large part because it is not politically expedient to eliminate the automatic adjustment provision for benefits. On the other hand, a lot of talk has taken place over the cure to a second problem—a basic flaw in the benefit formula.

Basic flaw in benefit formula.—It is important to look at this second cause of the long-range cost overrun of the system because major proposals to correct the problem have already been presented to Congress.[4]

The social security benefit computation formula is simply an equation to determine how much of the earnings that were lost by retirement, death, or disability will be replaced by the benefit. To arrive at the benefit amount, it is necessary to determine average monthly earnings covered under the system and multiply those by a now 9–part replacement formula.

The "flaw" present is traceable to the statutory changes in 1972. Under these changes, whenever benefits for those already on the rolls are increased to keep pace with the cost of living, the wage replacement fact is increased by the same percentage (see Table V attached). This assures that every future retiree who has the same average lifetime wage as a current retiree will receive the same benefit. The adjustment or indexing, however, overlooks the fact that average lifetime wages covered by the system are also rising and, therefore, the benefit formula is actually over-adjusted.

Until about 1995, this over-adjustment compensates for a different adverse phenomenon—the lengthening of the period over which wages are averaged.

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[3] There is of course the alternative of reducing expenditures elsewhere in the federal budget as an offset to higher social security benefits, but that is beyond the scope of this discussion.

[4] The Carter Administration in its budget message of February 22, 1977 notes that "[t]he proposed change to correct certain technical deficiencies in the adjustment of social security benefits is being deferred pending further study."

In 1950, the law was amended so that the averaging period includes only those years since 1950. As the averaging period gradually increases, the average lifetime wage will become smaller as a percentage of final wages.

Most proposals for correcting the benefit computation formula would eliminate the indexing of the wage replacement formula by freezing the replacement factors for three categories of earners—low, average, and maximum—and replace this adjustment by indexing the earnings history. "Indexing" earnings history translates each past year's earnings into current year's values by multiplying the past year's earnings by the growth that has taken place in some other economic factor.

The two most popular measures for indexing the earnings history are (a) wages or (b) prices. The difference between them is already an important issue for Congress.

The Ford Administration last June (MAPI Memorandum G–86) suggested wage-indexing the earnings history in order to stabilize the current relationship between benefits and final wages. Under this approach, all prior-year wages would have the same comparative value as wages earned in the year before retirement. This approach would eliminate about half the long-term deficit.

A "Consultant Panel" reporting to the congressional tax committees last April recommended indexing the earnings history by price. Since prices over a long period of time have not risen as rapidly as wages, the relationship of benefits to final wages declines continuously over time. Thus, all other things being equal, price-indexing develops more savings, and it could be employed to eliminate the entire deficit by itself.

The problem is obvious, however; price-indexing would result in an across-the-board reduction in benefit commitments for future retirees. Those who argue for price-indexing contend in this regard that adjustments can be made later by future Congresses whenever they believe it to be necessary.

To sum up, "decoupling," as both of the approaches are called, appears to have support, and it is likely that Congress will act on this in the 95th session. At the moment, it would appear the proponents of wage-indexing are in the majority.

Fertility rates.—The third major cause of the long-range deficit is the demographic shift. Knowledge that those born during the post-war baby boom of 1947 to 1954 will be retiring in the years from 2012 to 2020 has, of course, been built into the long-range projections. In addition, the actuaries have cranked in the fact that improved medical care, diet, etc., have swelled the number surviving to old age, pushing the death rate to new lows almost every year which means a steady expansion of the ranks of the aged.

However, the continuation and depth of the decline in the fertility rate following the baby boom have only recently been introduced as actuarial assumptions. More specifically, for the first 11 months of 1976, the rate was 65.7 births for each 1,000 women in the childbearing ages (15 to 44), down from 66.7 in 1975. At the crest of the post-war "baby boom" in 1957, the corresponding figure was 122.7; the previous low was 75.8 in 1936 during the depression.

Further, for the past several years the "total fertility rate," or the average number of children born to each family, has dropped below the "replacement level" of 2.1. This is the figure at which the population would, after some decades, cease to grow. From 3.7 children for each family in 1957, the total fertility rate fell to 1.8 in 1975. The Trustees have forecast this rate to average 1.9 for the next seventy-five years.

These changes in fertility rates would bring about the lowest ratio of working age population to retired population that the system has ever experienced. The ratio will shift from 30 beneficiaries per 100 workers in 1975 to 50 beneficiaries per 100 workers in 2030. To fund the additional beneficiaries with the smaller ratio of taxpayers would require an increase of about 20 percent over scheduled tax rates for each worker.

The most commonly cited solution is to extend the retirement age to 68 some time after the turn of the next century. A standard retirement age of 68 would sharply reduce the expected duration of the retirement period for all workers.

One of the interesting sidebar issues raised by the changing demographic makeup is the increasing attention older citizens will receive in the next 30–40

years. For example, there has been a trend toward early retirement and early retirement options in private plans. Counterbalancing this trend, there is now considerable support in Congress to remove at least the upper age limit in the age discrimination in employment law. Thus, instead of a protected group between the ages of 40 and 65, the law would protect people of all ages over 40 against discrimination in employment because of age. Should this change be enacted or should the current law be construed to be a barrier against company-dictated retirement before age 65,[5] it is possible to envision employees having the best of both possible worlds—able to retire early or to work to age 65 and beyond. In sum, the demographic shift is certain to impact socio-economic priorities and the political responses to these issues.

Concluding comments

It is fair to say that most observers recognize serious short- and long-range financing problems for social security. It is equally well known that the solutions such as lower benefits and/or tax increases are not easy ones. It would appear to be an ideal time to examine the future course of both the public and private systems. While to date, Congress has not shown any real interest in the compatability of the two programs, it is clear that the problems besetting the system call for Congress to think through a comprehensive set of changes which would be adequate to solve the total financial problem. In this process, a number of structural proposals are bound to be reviewed which could have a major impact on the future of the private system. In sum, it appears that the social security deliberations of the 95th Congress are going to be particularly important to the future of private plans.

TABLE I.—BENEFIT AND TAX PICTURE UNDER CURRENT LAW AND ASSUMPTIONS[1]

	January tax and benefit base	Current OASDHI tax rate (percentage)	Maximum tax payable for employer and employee each
Year:			
1977	$16,500	5.85	$965.30
1978	17,700	6.05	1,070.90
1979	19,200	6.05	1,161.60
1980	21,000	6.05	1,270.50
1981	22,800	7.30	1,664.40

[1] Based on testimony presented to the Joint Economic Committee by the Congressional Budget Office; see vol. 122, No. 88, Congressional Record at S8772, June 9, 1976.

TABLE II.—BENEFIT AND TAX PICTURE ASSUMING PRESIDENT FORD'S RECOMMENDATIONS ARE ADOPTED[1]

	January tax and benefit base	OASDHI tax rate (percentage)	Maximum tax payable for employer and employee each
Year:			
1977	$16,500	5.85	$965.30
1978	17,700	6.15	1,088.60
1979	19,200	6.45	1,238.40
1980	21,000	6.60	1,386.00
1981	22,800	7.85	1,789.80

[1] Based on President Ford's tax recommendations to Congress, Jan. 4, 1977; see vol. 123, No. 1, Congressional Record at S. 41, Jan. 4, 1977.

[5] See, for example, McMann v. United Airlines, decided by the Fourth Circuit on October 1, 1976. The Supreme Court has agreed to review this case.

TABLE III.—TRUSTEES' PROJECTIONS (INTERMEDIATE ASSUMPTION) OF THE PROGRESS OF THE OLD-AGE SURVIVORS INSURANCE (OASI) TRUST FRND FOR FISCAL YEARS 1977–81 [1]

	1977	1978	1979	1980	1981
Economic assumptions, calendar year:					
Annual increases in wages—subject to social security—percent	8.5	9.4	8.5	7.7	6.7
Annual increase in prices—percent	6.0	6.0	5.5	5.0	4.5
Rate of unemployment—percent	6.9	6.6	6.2	5.7	5.2
Maximum taxable wage—in thousands	$16.5	$17.7	$19.2	$21.0	$22.8
Total income—in billions	71.8	79.1	87.2	95.6	103.3
Total outgo—in billions	73.4	81.5	89.7	98.7	108.0
Net increase—in billions	−1.6	−2.4	−2.5	−3.1	−4.7
Reserve, end of year—in billions	35.9	33.5	31.0	27.9	23.2

[1] U.S. Cong., House, 1976 Annual Report of the Board of Trustees of the Federal Old-age and Survivors Insurance and Disability Insurance Trust Funds, 94th Cong., 2d sess., May 25, 1976, pp. 22–23 and 30.

TABLE IV.—TRUSTEES' PROJECTIONS (INTERMEDIATE ASSUMPTION) OF THE PROGRESS OF THE DISABILITY INSURANCE BILL (DI) TRUST FUND FOR FISCAL YEARS 1977–81 [1]

[In billions of dollars]

	1977	1978	1979	1980	1981
Total income	9.5	10.7	11.8	12.8	14.6
Total outgo	11.3	12.8	14.5	16.4	18.3
Net increase	−1.8	−2.1	−2.7	−3.6	−3.7
Reserve, end of year	4.8	2.7	[2] −.001	−3.6	−7.2

[1] U.S. Congress, House, 1976 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, 94th Cong., 2d sess., May 25, 1976, p. 32. The economic assumptions are spelled out in table III.

[2] Fund has no authority to go into a negative balance. These figures are demonstrative of what would happen if the fund were to borrow money.

TABLE V.—OASDI BENEFIT SCHEDULE, 1975, 1976, AND 1977 [1]

[In percent]

	1975	1976	1977
1st $110 of average monthly earnings [2]	119.89	129.48	137.77
Next $290 of average monthly earnings	43.61	47.10	50.11
Next $150 of average monthly earnings	40.75	44.01	46.83
Next $100 [3] of average monthly earnings	47.90	51.73	55.04
Next $100 of average monthly earnings	26.64	28.77	30.61
Next $250 of average monthly earnings	22.20	23.98	25.51
Next $175 of average monthly earnings	20.00	21.60	22.98
Next $100 of average monthly earnings		20.00	21.28
DO			20.00

[1] Source: Social Security Administration, U.S. Department of Health, Education, and Welfare. See Social Security Bulletin, July 1976, p. 41.

[2] The average monthly earnings (AME) is a worker's taxable earnings beginning with 1951, or age 22 if later, up to the year of disability, death, or attainment of age 62 (age 63 to 65 for men born before 1913)—less the 5 lowest earnings years—divided by the number of months in the computation years.

[3] At the beginning of 1977, the highest average monthly covered earnings possible are $634 for a male worker at age 65 and $650 for a woman. The monthly primary insurance amount at $650 average monthly earnings (AME) is $422.40.

Note: This table shows the progression of the now 9-part formula used to determine the "primary insurance amount" (PIA) which is derived from the worker's covered earnings or "average monthly earnings" (AME). Whenever a cost-of-living benefit increase becomes effective, the new PIA is calculated by increasing the old PIA by the same percentage as the cost-of-living increase. If the contribution and benefit base is raised, the benefit formula provides an additional 20-percent replacement on that part of the AME above the previous contribution and benefit base.

AMERICAN ACADEMY OF ACTUARIES,
Washington, D.C., August 8, 1977.

Hon. RUSSELL B. LONG, *Chairman,*
Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: The American Academy of Actuaries was sorry that the timing of the Senate Finance Committee Subcommittee on Social Security did not allow the appearance of Mr. Robert F. Link, Chairman of the Academy's Social Insurance Committee. Since actuaries play such a vital role in the funding decisions of social security as well as all pension and insurance programs, we would like to play an active role in any future hearings of your Committee in these areas.

In the hearings before the Social Security Subcommittee of the House Ways and Means Committee, Mr. Link shared some thoughts and perspectives, which I think would be valuable to your Committee and staff.

Thus, I would ask and suggest that Mr. Link's statement to the House Committee be entered into the record of your Committee in order to lend valuable insight. We appreciate this opportunity, and we look forward to working with the Committee in the future.

Sincerely,

FREDERICK D. HUNT, Jr.

STATEMENT TO THE SUBCOMMITTEE ON SOCIAL SECURITY OF THE HOUSE WAYS AND MEANS COMMITTEE BY ROBERT F. LINK, CHAIRMAN OF THE SOCIAL INSURANCE COMMITTEE OF THE AMERICAN ACADEMY OF ACTUARIES, JULY 18, 1977

INTRODUCTION

Stephen G. Kellison, Executive Director of the American Academy of Actuaries:

Mr. Chairman, members of the Committee, my name is Stephen G. Kellison and I am the Executive Director of the American Academy of Actuaries. The Academy maintains its Washington offices at 1775 K Street, N. W., Washington, D. C. 20006.

By way of background, the American Academy of Actuaries is a professional organization of actuaries which was formed in 1965 by the four constituent actuarial organizations in the United States as an organization for the accreditation and public recognition of actuaries, regardless of areas of specialization. Despite the relatively short duration of the Academy's formal existence, the Academy and its constituent organizations have represented the actuarial profession in the United States for over eighty years.

As of December 31, 1976, the membership of the Academy stood at 4,137. These actuaries have a variety of types of employment including insurance organizations, consulting firms, government and academic institutions. Full membership in the Academy can be attained only by satisfying both extensive education and experience requirements. Well over 90% of those eligible to join the Academy do, in fact, do so. The entire Academy membership is subject to rigorous guides to professional conduct and standards of practice.

Actuarial science involves the evaluation of the probabilities of uncertain future events, often over long periods of time, and the financial impact which these events involve. The computation of financial values for insurance and pension programs in both the public and private sectors is a major application of actuarial techniques. The actuarial nature of the financing arrangements for Social Security has been recognized since the inception of the program in 1935. In recognition of the extreme importance to society of maintaining the financial integrity of the Social Security system the Academy formed its Committee on Social Insurance several years ago. The Committee includes some of the most eminent actuaries in the United States with a wealth of experience in both the public and private insurance and pension programs.

With me today is the chairman of that committee, Robert F. Link. Mr. Link is also Vice President and Actuary of The Equitable Life Assurance Society in New York. He will now present a statement for inclusion in the record of these hearings on Social Security funding.

Statement of Robert F. Link

Mr. Chairman and members of the Committee. I appreciate the opportunity to comment on the Social Security issues that Congress must currently deal with. Many actuaries have an intense interest in and concern with these issues. They are largely political: Should benefits be larger or smaller? Should the burden of paying for them fall more heavily on one group or another? And so forth.

Actuarial expertise can illuminate the consequences of one or another course of action; however, other talents may be needed to judge whether such consequences are good or bad. My comments are offered in this spirit. You will understand that, though many actuaries would agree with what I have to say, others may not; I do not represent a consensus or vote of actuaries. I do reflect the desire of actuaries to be helpful in the resolution of these difficult issues.

Specifically, I would like to address questions of strategy—rather than detail—in four subject areas. These are (a) decoupling, (b) decisions on benefit levels, (c) solution of financing problems, and (d) universal coverage and "opting out." The OASDI system is essentially an income replacement system. For simplicity, I'll be talking today as if it were a retirement system, mainly ignoring the disability and survivors' benefits except where I refer to them specifically, and completely ignoring health benefits.

Any discussion of what to do about Social Security has to start with some agreed upon understanding of the context, the purposes of Social Security, and the complementary or competing roles of other income replacement systems. My context is the whole range of income replacement systems, where Social Security provides a basic floor of retirement protection; private arrangements supplement basic floor Social Security benefits for those who have the necessary financial means or employment context, and various forms of welfare fill in where neither Social Security nor private arrangements are doing the job.

Where income security is to be provided by public programs, there is an interesting interplay between welfare and Social Security. Welfare uses a means test. This makes it more "efficient"; dollars spent on welfare go by and large where they are needed to do the job and generally not where they ar not needed. Thus, attaining minimum income objectives through welfare should cost less than attaining them through Social Security. There's no means test in Social Security, which makes it a more dignified approach from the viewpoint of beneficiaries.

What about the private arrangements? Private pensions have done an immense job. They have not escaped legitimate criticism, and ERISA is generally a step in the direction of improvement, though not without its critics. However, private arrangements do one thing that the other systems by and large don't do. They accumulate capital. This capital is taken out of current consumption and then re-enters the consumption stream at a later point. Not only that, but what re-enters exceeds in real value what is taken out. Unlike Social Security, private arrangements tend not to put a burden on future workers, because the burden has already been paid by current workers. And the capital that is generated helps to build and sustain the economy.

I review this familiar material to underline a point. OASDI is an income replacement system. Decisions concerning it should be made within the context of all major national income replacement systems, with careful attention to interrelated impacts. This interrelationship comes back again and again as we consider specific issues.

DECOUPLING

Decoupling is apparently non-controversial. Everybody wants to do it. The only questions have to do with how and to some extent with initial benefit levels. Actuaries have participated in the development of the Advisory Council approach to decoupling, on which the proposals of the Administration and the American Council of Life Insurance are based. They have also participated in the work of the Panel of the Congressional Research Service, which developed an alternative approach. In early 1976, the American Academy of Actuaries issued a position paper favoring decoupling. A copy is attached to this testimony.

Actuaries have no united position as to whether the Advisory Council approach or the Panel approach would be preferable. However, in approaching this question, it is helpful to have several points in mind.

1. There are some differences between the two approaches relating to transition arrangements, initial benefit levels, formula breakpoints, and so forth. The crucial difference is the basis for indexing the wage history—by average wages or by the CPI. Unless a new method surfaces, a decision should be made on the indexing basis. The other features can then be tacked on.

2. With reasonable assumptions, the standard of living for successive waves of newly retired persons will rise under either approach. Under the Advisory Council approach, it will rise as fast as it does for workers. Under the Panel approach, it will rise more slowly than it does for workers.

3. The Advisory Council approach intends to fix a scale of replacement ratios that will remain level in the future. The Panel approach expects replacement ratios to decline, leaving room for Congress to adjust the system from time to time in accordance with currently perceived benefit standards.

4. These adjustments can be technically troublesome. Trying to make sensible changes that are consistent for people who have just retired and people who are about to retire leads to benefit formulas that are complicated and messy.

In the remainder of this discussion, when considering benefit levels and financing, I am assuming that replacement ratios will be stabilized at some level, rather than permitted to drift upward or downward. This doesn't indicate a preference for the Advisory Council approach; it merely recognizes that one likely result under the Hsiao panel approach would be that benefits would be adjusted from time to time to restore replacement ratios.

BENEFIT LEVELS

There is a vast lore of guidance and instruction as to appropriate benefit levels in income replacement systems. However, there is one universal principle. The replacing income under all programs should generally not be higher than that necessary to provide the individual or household with a net purchasing power comparable to that of the replaced income. This will mean in most cases that the objective for dollar income after retirement will be *less than* the income before retirement, to take account, for example, of reductions in living expenses and taxes. Turning for a moment to disability coverages, providing too much income puts the temptation on the side of being disabled rather than working. Some believe that excessive benefit levels may have something to do with the serious upward drift in disability experience under Social Security in recent years.

This principle should be observed in the Social Security system as well as in the broader complex of systems of which it is a part. However, beyond this, Social Security must be considered in the light of its particular nature as a contributory system and its relationship to other income replacement systems. This leads me to suggest five criteria that might be used when Social Security benefits levels are under consideration. These are as follows:

1. *Benefit levels should continue to be based on the earnings record in covered employment.*

2. *The benefit formula tilt in favor of the lower paid should be retained.* However, I think the benefit formula needs to be fixed to remove some anomalies that I will point out shortly.

3. *If workers are willing to pay the necessary taxes, the benefits should be made sufficient so that an individual or family nor requiring welfare before entitlement should on the average not require welfare after entitlement.* "On the average" means we might do more than enough in a low-cost area and not enough in a high-cost area. I'm sorry that I don't have good information on the benefit levels needed to meet this criterion. Some research is needed. However, note the proviso: if workers are willing to pay the necessary taxes. It may turn out that they won't be, in which case some benefit load will be shifted to welfare—and will be a lower cost as a result.

4. *The benefit level should not be higher than necessary to provide the same net purchasing power that would be provided by earned income in covered employment before retirement.* This principle fits somewhat with the preced-

ing one. As long as we have an earnings based system, the benefits in relation to earnings should be reasonable.

5. *For persons with significantly less than full term of covered service, benefits should be proportionately reduced.* This is clearly not the case at present. People with short periods of covered employment get their wages spread over a long period for purposes of calculating benefits. In this way, the system treats them as long service low paid persons rather than shorter service higher paid persons. Thus, the benefit tilt in favor of low paid persons operates in favor of higher paid persons with short coverage. This result is aggravated by the minimum benefit, which is not justified by any of the principles that I've just stated.

The benefit formulas and the law should be designed to eliminate the anomalous excess benefits for persons with very low average wages and persons with short histories of covered employment. I'd be delighted to discuss with your staff some possible approaches to accomplishing these results in an orderly way, if you desire that.

FINANCING STRATEGY—SHORT-TERM

Our Social Security system has traditionally been financed by a payroll tax imposed essentially equally on employees and employers. The amount of financing has been controlled in two ways: first, by adjustments in the tax rate from time to time as the system matured and more beneficiaries came on the rolls; and second, by upward adjustments in the dollar amount of maximum covered wages as average wages increased through the years under the force of rises in the cost and standard of living. Originally, the maximum was set at a point where 97% of covered persons were taxed on all of their wages. This percentage drifted down to a level of 64% in 1965. Increases since then have brought the percentage back to about 85% currently.

Some are now suggesting that this traditional system of equal employee-employer taxes on a wage base that moves roughly with general wage levels will no longer do the job. This has led to much greater pressure than formerly for such steps as increasing the maximum wage beyond the now automatic increases in the law, taking the maximum off entirely for employer contributions, and resorting in various ways to general revenues. Choices among the various alternatives do not present primarily actuarial issues; the issues are those of politics and policy. However, it is clear that these recent proposals involve important changes in our view of the system, raising issues of whether Social Security is a welfare system or not, what its role should be relative to other systems, and so on. The conservative approach would be to stick as long as we can with the traditional financing mechanisms before moving into new mechanisms.

Actuaries have something to say on this subject. We often observe the widespread human tendency in connection with benefit plans of all kinds to understate, minimize, or even conceal the costs while nevertheless providing or increasing the benefits. This is bad enough when it happens in the private sector. As we all know, it has also happened in the public sector. The one lesson in the developing financing problems of the municipal and other public systems is, keep the real costs visible. Only in this way can those who pay the costs be provided with an occasion to bring their influence to bear on benefit levels.

The great virtue of the traditional financing system is that it does this. The other suggested methods of financing won't do it as well, because they put added costs in places where there is less visibility and voting power. This is certainly true when you go to general revenues. It is also true when costs are placed disproportionately on employers. It is true when the maximum is raised for employees. And remember: raising the employee maximum ultimately raises benefits and is thus self-defeating.

It has been suggested that an increase in employer taxes will come out of profits. My economist friends tell me that an increase will most probably translate into lower wage increases or higher prices. If so, the cost would be paid either by employed persons or by consumers.

Here's a suggested strategy for dealing with the short-range financing problems. The strategy is to stick with the traditional methods as long as possible,

hope that these will work, and don't break new ground that changes the nature of the system until you have to. Maybe it will turn out that you don't have to. We haven't yet exhausted the tax rate as a resource. Even the Administration proposals contemplate significant tax rate increases, only they come at the back end of the changes. Is it possible that some could be put up front? And let the automatics take care of the traditional base increases? The present employer-employee tax rate for OASDI is 4.95%. It has been estimated that the benefits proposed by the Administration could be financed by a tax rate of about 5.5% in 1980 and 5.7% in 1986. If the American Council of Life Insurance proposal were followed, with its phased reduction of about 10% in replacement ratios, the corresponding tax rates would be about 5.4% in those years. These rates assume no further decline in trust funds before 1980 and trust fund increases thereafter equal to one-half the annual increase in benefits. None of the rates appears to be impossibly high.

FINANCING STRATEGY—LONG-TERM

The central fact that must be reckoned with in addressing long-term financing is the change in population mix. There are currently about thirty-one beneficiaries per hundred workers. In the early 21st Century, that will rise to fifty beneficiaries per hundred workers. Social Security benefits as a percentage of GNP in 1979 are projected at 4.5%; under decoupling as proposed by the Administration, they would rise to 7.8% in the early 21st Century. The questions transcend Social Security. How are we going to provide for all those retired people without imposing unduly on workers? There are only four basic strategies: (i) reduce the relative benefits for retired persons; (ii) keep people in the work force longer (i.e., raise the retirement age); (iii) let a heavier burden rest on future workers than we have today; or (iv) increase the total pie of goods and services so as to make up the difference.

Here are a few thoughts on how to address the long-term problem. First, recognize that it is really long-term. There is lots of time to turn the Social Security ship in the direction we want to go. Lots of time to make studies and reach for integrated, broad-scale solutions.

Second, while the ratio of Social Security beneficiaries to workers is increasing from thirty-one to fifty per hundred, the corresponding ratio for dependent children is falling off. This change may contribute to a greater capacity to support the retired aged.

Third, don't forget private pensions and personal savings, which take goods and services out of consumption now so as to deliver them in larger measure when needed later. By transferring resources between generations, private pensions reduce the inequities that would otherwise be present. And they accumulate all that capital that we need so badly.

The real issue is a basic philosophical one: shall Social Security be a basic floor of protection, or do we want it to meet the full retirement need of a major segment of the population? If we want the first, then we should be

Fourth, consider the retirement age question. If the medical advances that some are predicting should come to pass, this is an absolute must at some point. It's not too soon to start doing some long range thinking about it. Remember that the retirement age issue ties in with our current problems of unemployment and under-employment.

Fifth, people have proposed that the index for retired beneficiaries should be something other than the CPI. I suspect that some of those who make the proposal expect it to produce larger benefits, while others believe it will produce smaller benefits. If we are going to do anything about it, we should do the work as a preliminary to designing ultimate solutions for the long-term financing problems.

UNIVERSAL COVERAGE AND OPTING OUT

There is one aspect of the Social Security system that many observers find concerning. It is the position of government employees with respect to the Social Security system. Let's take permanent Federal employees first. They are not covered by Social Security. However, many government employees retire on full benefits, work for a period in the private sector, and get a Social Security benefit.

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Furthermore, because their short earnings record is spread over a long period of potential coverage, the system mistakenly regards them as low-income persons and they benefit from the features of the system that favor low-income persons. This appears to be an unwarranted windfall at the expense of Social Security taxpayers generally. It must cost other taxpayers something. This is significant in relation to the current discussion of financing problems.

The natural way to fix this up would be first, to change the law so that Federal government employees are covered under Social Security, and second, amend the various government retirement systems to take appropriate account of this coverage. This is how it is typically done in private sector pension plans. If permanent Federal employees were covered by Social Security, average benefit costs over the next seventy-five years would be reduced by about 0.11% of covered payroll. More importantly, because benefit liabilities build up slowly, such a step could in effect put an extra $30 billion or so into the trust funds in five years, if initiated in 1980.

If we don't include these Federal employees in Social Security, we should at least amend the benefit provisions of Social Security in ways that I suggested earlier, so that a person with a short history of covered employment would have his benefits figured on the basis of his average for that short period with a pro-rating downward to recognize the fraction of actual coverage to full career coverage. I don't have any estimate of the cost effects.

In the case of groups of state and local employees and certain other groups where Social Security is optional, there is a much worse situation. Some have elected not to be covered by Social Security. These groups present the same problem and extra costs as do Federal employees. Those who have elected to be covered are increasingly considering the option to terminate coverage.

These termination situations are of deep concern to actuaries. In certain situations, the pressures to terminate are very strong because of the Social Security tax expense. Actuaries are being asked to give consultation on the relative merits of continuing or terminating coverage. The considerations are extremely complex. The private sector can't really duplicate Social Security benefits very well. The comparison involves the unknown future development of Social Security.

However, there is an expectation that in many cases it will be *on balance* financially advantageous for a unit to opt out. The withdrawal in these cases would therefore be expected to raise the taxes for everybody else. Actuaries are distressed that their obligation to give consulting advice can contribute to an exacerbation of the financing problems of Social Security.

It would be desirable to find some way of achieving universal coverage of the groups for whom Social Security is now optional. I realize that the Constitutional separation of powers creates a problem; however, I would hope the obstacles are not outside the power of Congress to overcome if it wishes to.

CONCLUSION

I appreciate greatly the opportunity to express these views. Actuaries are vitally interested in the subject, and a number of them have participated in various ways in recent developments. If you see any other way that we can help, we'd be delighted to be asked.

STATEMENT BY THE AMERICAN ACADEMY OF ACTUARIES CONCERNING THE U.S. SOCIAL SECURITY BENEFIT FORMULA

This statement is issued on behalf of the American Academy of Actuaries[1] by its Committee on Social Insurance. Actuaries by their training and experience are uniquely qualified to deal with the financing of systems providing protection against the financial consequences of death, disability, and old age. Actuaries have a strong professional interest in such systems, whether private

[1] The Academy is an organization of nearly 3,500 actuaries employed by insurance companies, actuarial consulting firms, commercial and industrial firms, academic institutions, industry associations, and federal, state, and local governments. The Academy is broadly representative of the actuarial profession in the United States. It includes members of the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, the Fraternal Actuarial Association, and the Society of Actuaries. Attached is the section of the 1975 Year Book of the American Academy of Actuaries describing its Historical Background.

or social insurance systems. In a spirit of professional public service, and with the intention of meeting the responsibilities of actuaries to the public, the Academy makes this recommendation to those persons in the federal government ultimately responsible for the satisfactory development of Old-Age, Survivors, and Disability Insurance under Social Security. The American Academy of Actuaries endorses in principles the recommendation of the 1974–75 Advisory Council on Social Security [2] with respect to changes in the benefit formula to stabilize the ratios of initial monthly benefits to earnings prior to claim. Under various conditions of inflation or deflation, the ratios produced by the present benefit formula can change over the years in an irrational and unsatisfactory manner. Action to stop the drift of replacement ratios, upward under certain conditions and downward under others, is badly needed. Furthermore, such action must not be long delayed because the present formula will produce unsatisfactory results and costs under current conditions of inflation.

At this time we are not endorsing the details of the benefit formula changes proposed by the Advisory Council or by others. We realize that a panel of actuaries (all of whom are members of the Academy) and economists, engaged by the Congressional Research Service, Library of Congress, is examining these details to see whether an alternative formula would be preferable. Committees of actuarial organizations will follow this work closely. Therefore, it is premature for the Academy to take a position with respect to the precise formula, but we expect to do so in due course. We believe, however, that it is not too early to endorse the "uncoupling" principle recommended by the 1974–75 Council.

Members of the Academy are fully aware that neither the short-term nor the longer-term financial problems of the Social Security system will disappear simply because the "uncoupling" principle is adopted. "Uncoupling" will help substantially, but still additional financing will certainly be required. Nonetheless, "uncoupling" is essential and is a practical step toward improvement in the financial situation of the OASDI system. It will go a long way toward reducing the expected long-term actuarial imbalance between taxes paid into the system and outgo in benefits and it will produce more rational results than the present formula.

Legislation to accomplish "uncoupling" can be enacted in combination with further measures required to provide additional financing needed to meet the developing short-term cash-flow problem. Alternatively, and in our opinion preferably, the "uncoupling" legislation, being non-controversial in nature, can be enacted independently. We urge that it be enacted as soon as a carefully considered benefit formula is agreed upon, hopefully before the 94th Congress ends its work.

Statement of the Air Transport Association of America

The Air Transport Association of America, representing virtually all of the U.S. scheduled airlines, appreciates this opportunity to comment on the proposed changes in the funding of the Social Security system recently recommended by the Carter Administration. The airline industry is highly labor-intensive, and it will be especially affected by any modification of the Social Security program.

The airline industry fully recognizes the necessity of adequately financing the Social Security system, and it is obvious that under the current provisions the program cannot continue to be self-sufficient. Consequently, it is imperative that steps be taken to place the Social Security system on a financially solvent basis. However, we do not agree with certain suggestions offered by the Administration.

WAGE BASE

The Administration proposes that employers contribute to the fund on a continuously rising employee wage base until 1981, at which time the employer's contribution would be based on the employee's entire salary, while the employee's contribution would be pegged to a significantly lower wage base.

The wage base under the current law increases from $16,500 at 5.85% in 1977 to $23,400 at 6.30% in 1982. The Administration's proposal would increase

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[2] Chapter 3, pages 13 to 18 of the Report of the Council.

the wage base for an employee from $16,500 at 5.85% in 1977 to $24,600 at 6.30% in 1982 and increase the wage base for the employer from $16,500 at 5.85% in 1977 to the entire salary at 6.30% in 1982.

The financial burden this would place on the employer is excessive and inequitable. Consequently, the airlines strongly oppose this aspect of the proposal.

Congress established the Social Security program with the intent that it would be self-sufficient and that the employer and employee would share equally in the cost. If the fund is now in difficulty, the employer and employee should share equally in any solution. To do otherwise would negate the fundamental tenets of the program.

As previously indicated, the airline industry is particularly labor-intensive with 41.5% of cash operating expenses attributable to labor. The inequitable increase in the employer's contribution under the Administration's plan would raise the airline industry's FICA contribution an estimated 17% in 1981, 21% in 1985 and 38% in 1990 over that provided by current law. The airline industry does not enjoy profit margins sufficient to absorb the increased expense necessitated by the Administration's proposal, and consequently, the price of air transportation to the public would have to increase if the proposed modifications are adopted.

Another significant outgrowth of increased employer contribution would be the adverse impact on employee pension plans. The majority of airlines maintain such plans, which are the subject of labor negotiations. The employers' contribution to the plan is one of the many issues subject to collective bargaining. The increased financial burden of the Administration's Social Security proposal could preclude increased employer-participation in industry pension plans. Thus, the employee's gain in Social Security benefits could be more than offset by the loss of company contributions to benefit plans, which generally have greater retirement benefits than those provided by Social Security.

CONTRIBUTION RATE

In addition to increasing the contribution rate 7.7% (from 5.85% to 6.30%) in 1982, which conforms to the current statutes, the Administration proposes to augment these increases with additional increments in 1985, to 6.55%, and 1990, to 7.45%. A more reasonable approach has been recommended by the U.S. Chamber of Commerce.

The proposal of the Chamber of Commerce would advance to 1978 an increase in the Social Security contribution rate of a minimum of three-tenths of one percent. The Chamber's recommendation recognizes that raising the contribution rate is the most effective means to generate the required funds and that altering the wage base in favor of either the employee or the employer is inequitable.

The Chamber approach is the most responsible and equitable method of placing the Social Security system on a sound financial basis. Consequently, the U.S. airline industry supports this alternative, which retains the original intent of Congress for employee and employer parity and which will provide sufficient funding to restore the plan to financial stability.

DECOUPLING

The airline industry endorses the Administration's efforts to correct the excessive adjustment for inflation which inadvertently developed when future Social Security benefits were coupled to an index of wages and the Consumer Price Index. The anticipated annual deficit, if the current plan is not modified, could be reduce by one half if the decoupling recommendations of the Administration were adopted or by two thirds if the recommendations of the Chamber of Commerce were adopted. Regardless of the alternative selected, it is imperative that Congress rectify this situation.

GENERAL REVENUE

The Administration has also proposed a special counter-cyclical procedure which would utilize general revenue to replace lost contributions to the Social Security system when the unemployment rate exceeds six percent. The Air

Transport Association considers this proposal to be extremely questionable. In view of the continuing national deficit, there is little logic in drawing upon unavailable funds to support the valuable Social Security system. Such action would either increase our already staggering national debt or increase taxes generally. The Administration's proposal would also undermine the fundamental relationship of benefits to contributions.

SUMMARY

Recognizing the need to return the Social Security system of this country to a sound financial status, the Air Transport Association of America recommends:

Retaining an equal wage base between employer and employee;
Raising the Social Security tax by .3% for both employer and employee;
Decoupling the method for adjusting for inflation; and
Rejecting the use of general revenue funds for Social Security.

The Air Transport Association appreciates this opportunity to comment on the proposed modifications of the Social Security system, and we hope that our comments will assist in the deliberations over these issues of such great concern to us all.

Statement of Jerry Wurf, International President of the American Federation of State, County, and Municipal Employees, AFL–CIO

Mr. Chairman and members of the subcommittee, I am Jerry Wurf, International President of the American Federation of State, County and Municipal Employees. Our union has over 750.000 members who work for state and local governments and, when we negotiate for wages and working conditions, we represent more than 1.5 million public employees.

We are in substantial agreement with the Administration's short and long term Social Security financing reform proposals. The Administration's program, if enacted, should go a long way towards preserving the fiscal integrity of the nation's most important social insurance program.

However, there is one major area of the Social Security program which the Administration has not touched upon that also is in serious need of reform. This pertains to the coverage provisions of the Social Security System, particularly as they impact upon state and local government workers.

I want to urge that coverage under Social Security be made universal. The System should not only include workers in private industry, but also all state and local government employees, federal employees, and even members of Congress and their staffs.

The present Social Security coverage situation for state and local employees in particular is neither healthy from the worker's standpoint nor from Social Security's standpoint.

a. From the worker's standpoint

Before a state or local government can join the Social Security System, its employees must vote to be covered. But the Social Security Act also gives public jurisdictions the unilateral power to terminate coverage for their employees. These provisions are inconsistent and unfair, and have proven to work to the detriment of the public employees who really need the income security protections of the Social Security System.

The facts are that general, nonuniformed state and local workers, who have their coverage terminated, are the ultimate losers because Social Security benefits cannot be replaced. This was clearly demonstrated in recent studies of the cost of replacing Social Security benefits for Alaska and California state workers and for employees of San Jose, California.

The State of Alaska—the only state government thus far to submit a withdrawal notice—requested that the William M. Mercer Company, an independent pension consulting firm, detrmine what the cost to the State would be for replacement of Social Security benefits, should the State go ahead and withdraw from the System. The Mercer report estimates that it would cost the State a whopping 22 percent of payroll to fully replace lost retirement, disability and death benefits provided by Social Security. The cost of partial re-

placement of lost benefits, based upon four alternative programs, would range between 12.5 percent and 19.25 percent of payroll. The report stressed, however, that these figures only represent benefit replacement costs. They do not reflect the high cost (and difficulty) of administering such a program.

The Wyatt Company, another independent pension consulting firm, recently studied the impact of termination of Social Security coverage on the State of California and its workers. The Wyatt report concluded that the cost of replacing Social Security benefits by a state program would be prohibitive, estimating that even partial replacement of benefits would cost the State 12.32 percent of payroll. Subsequently, the Commission on California State Government Organization and Economy, which requested this study, issued its own report to the Governor and State Legislature, not only recommending that the State continue to participate in Social Security, but also urged that coverage be made universal throughout the country for public employees at all levels of government.

A third study was recently completed by Robert J. Myers, former Chief Actuary of the Social Security Administration. He examined whether San Jose, California, which has withdrawn from Social Security, was able to replace the benefits which city workers lost. He, too, concluded that benefits lost by opting out of Social Security were far greater than any improvements made in the City's pension plan.

The reason for this unanimity among the experts on this point is because Social Security, over the last 40 years, has emerged as the cornerstone of the American worker's income security. Social Security is more than a retirement system. It also provides income for workers who are permanently and totally disabled and for survivors of workers who die prior to or after retirement. In addition, it is a health insurance system, which protects permanently and totally disabled workers and retirees against the rising cost of health care.

The only workers that truly benefit from opting out are higher paid public employees, police and fire for example, who retire in their late forties or early fifties and qualify for Social Security benefits through second career employment. I might add that this also is the case with respect to federal employees, 50% of whom qualify for Social Security by moonlighting or through a second career.

The danger of the present voluntary system of entry into and exit from the Social Security System also focuses on the state and local workers who have never had coverage, as in Massachusetts. These workers frequently have to rely on financially unstable state and local pension plans for their retirement security and certainly do not have the scope of income security protection afforded by Social Security in cases of death, disability, or other contingencies.

To underscore the significance of this last point, it should be understood very clearly that there is an interrelationship between Social Security coverage for public employees and the stability of state and local pension plans. The facts are that the current funding problems of state and local pension plans cannot be resolved unless Social Security is made the basic income security program for all public employees. Without universal coverage, the cost of providing even substandard public pensions by financially strapped state and local employers will continue to be prohibitive.

b. From the social security system's standpoint

In my opening remarks, I indicated that the present public employee coverage situation is unhealthy for the System as well as for the worker.

Present coverage provisions represent a financial drain on the Social Security System. They encourage abuse by some public employees, enabling them to qualify for Social Security benefits that are far greater than their contributions. And as a whole, the four million state and local employees and 2.6 million federal employees currently not covered by the System have become a substantial source of lost income to the Trust Funds, which presently are experiencing a $5.6 billion deficit. This was clearly demonstrated by Social Security estimates of the impact of future public employee entry into or exit from the System.

The Social Security Administration has estimated that if coverage is terminated for one-half of the 8 million state and local workers who are currently covered, the loss in contributions and interest between 1978 and 1982 would be $37.2 billion! On the other hand, if all 12 million state and local employees

were covered under Social Security on a mandatory basis, an additional $35.2 billion would be added to the Trust Funds. The Social Security Administration also estimated that the long-range fiscal impact of extending coverage to all state and local workers would be a reduction in the cost of the cash-benefits ment are required to receive full Social Security benefits, the incentive for hospital insurance program.

As you are well aware, federal civil service employees (including employees of the Social Security Administration) are not covered by Social Security. This is because the federal government, as their employer, has chosen not to do so, even though it has elected to cover the military for the past 20 years.

Nevertheless, it is estimated that nearly 50% of the 2.6 million civil service work force become eligible for windfall Social Security benefits anyway through outside or second career employment. Since only 10 years of covered employment are required to receive full Social Security benefits, the inentive for "double-dipping" is significant.

The Social Security Administration estimates that if this situation were corrected, mandatory federal employee coverage would, over the long run, reduce Social Security costs by about 0.17 percent of taxable payroll for the cash benefits program and 0.06 percent for the hospital insurance program.

In light of these figures, I strongly urge that the Subommittee seriously consider incorporating the concept of universal coverage as an integral part of the Social Security financing reform program that it will be considering. It certainly would be a logical extension of the theme of the Administration's proposals, which we support—that is, to preserve the short and long term fiscal viability of the Social Security System. The direct link between universal coverage and the fiscal integrity of the System is sufficient grounds to advocate universal coverage, to say nothing of supporting it for equity reasons.

Statement of American Society for Personnel Administration

Mr. Chairman and members of the subcommittee: The American Society for Personnel Administration (ASPA), with headquarters in Berea, Ohio, now in its 28th year, is a world-wide professional organization of personnel and industrial relations practitioners in business, industry, government and education. With approimately 20,000 members in over 200 chapters in 50 states, ASPA also serves members in 26 foreign countries. There are also almost 100 student chapters on college and university campuses across the United States.

The purpose of our testimony today is to advise the Congress, and specifically, the responsible committees within the legislature, of our concern over the existing financial state of the Social Security system and the significant change in direction being proposed by the current administration and some leaders in Congress. Through our recommendations, we hope to alert your committee to the potential dangers which exist in some of the proposed recommendations and assist you in developing sound concepts and fiscally responsible conclusions in your final deliberations in this matter.

PREFACE

The 20,000 members of ASPA believe that our current system for providing human dignity in retirement through adequate retirement income must be viewed as a unified whole, with Social Security, public retirement plans, private retirement plans, and the financial resources of individuals each serving an important role in meeting the needs of our current and future retirees.

Congress recently completed a thorough study of the private retirement system, and has offered encouragement to individuals, through establishment of Keogh Plans and IRA's, to make individual provisions for their financial requirements during their retirement years.

We believe that it is now time to subject the Social Security system to the same national review and detailed type of study that was the fore-runner of ERISA. Only through a total and thorough review can the necessary changes be implemented that will allow the Social Security system to continue to be the cornerstone of the total retirement system needed to provide security and dignity in retirement for our citizens who have contributed a working lifetime to our society.

FACTS

Based on reports, studies and articles by the Social Security Trustees, Consultant Panel on Social Security, prominent educators, the Chief Actuary of the Social Security Administration, the ex-Secretary of the Treasury, expert consultants, and professional groups, it has become apparent that the Social Security system has developed both short and long term problems that threaten the integrity of the system.

There are minor differences in the estimates and assumptions used by different individuals and study groups, but all agree that either benefits must be reduced and/or increased revenues must be generated in order to solve the problems inherent in the Social Security system.

ASPA POSITION

Conceptual

It is in the best interest of the United States of America to maintain a multilayered system of providing retirement income through Social Security, public and private pension plans, and the financial resources of the individual.

Social Security should provide a retirement income base only, and should not be allowed limitless expansion which in itself threatens our economic resources.

Benefit payments must be a function of the premium taxes collected and the financial resources pledged and available to the program in the future.

Long term

Benefits should be allocated in relation to a percentage of the individual's final average salary, and that replacement ratio should be retained through post-retirement increases based on CPI increases.

Short term

The Survivor's and Retirement Trust Fund should be retained and made fiscally sound.

RECOMMENDATIONS

Although there are many alternatives available to correct the present situation, they all require increasing the tax and/or reducing the benefits. We recognize that some are more palatable than others. However, it is important to note that no one corrective action by itself can solve the problems of the program and that some actions which might be taken would create as many problems as they would solve.

The following, however, are recommended actions which, in our opinion, are both reasonable and necessary if the Social Security system is to continue as a viable program to serve those who are now entering the workforce and will expect to retire with Social Security benefits 30 or more years from now.

You will note that in our specific recommendations we have attempted to incorporate both short and long term solutions. This was done deliberately in order to avoid a "quick fix" remedial set of actions which would solve today's problems at the expense of longer, more lasting solutions which we feel are vital at this time. To avoid the difficult, long term fiscal and conceptual problems will do nothing more than relieve ourselves of more painful decisions which will have to be made in the future. Therefore, we strongly advise that in your deliberations on this important issue, you continue to focus on (1) the initial concept and purpose of the Social Security system—which we heartily support, and (2) the potential impact of dramatic changes and shifts away from the current system of multilayered retirement income, and (3) the fiscal responsibility for maintaining a fair and equitable system with co-equal partners of business, labor, government and our citizens.

Recommendation 1.—The tax rate should be immediately increased by 0.3 percent for both employers and employees.—With the resultant increase from 11.7 percent to 12.3 percent, we believe that the additional revenue would reestablish the former circumstances where premium income exceeded benefit payments.

It is our belief, as unpopular as it may be to various groups, that an immediate tax rate increase is in order as an initial step required to bring quick and expeditious relief to the system. Based on the expert predictions of the state of the various Social Security funds, we believe an immediate increase would not

only help fiscally, but have a positive psychological impact on the country as a whole and restore confidence in the system. Although opinions vary on the size of a potential increase, we believe a .3 percent increase is sufficient to provide the degree of relief appropriate at this time. We do not concur in the Administration's recommendation to delay tax increases from 2071 to 1985 and 1990. We believe that these proposals would still leave a deficit.

Recommendation 2.—We recognize that the employee's contribution to Social Security has been a portion of employee income subject to income tax. That part of Social Security income for an individual which could not be attributed to his own contribution is income which has not ever been subjected to income tax.

As a possible means of developing additional revenues, we believe that a formula could be devised by which an appropriate tax on Social Security income could be levied. This could be established in such a way that such a tax would not have adverse impact on persons with income at the lowest end of the scale. However, many persons receiving Social Security income receive this as a supplement to other adequate income. Therefore, if a modest tax were paid on this supplemental Social Security income, and earmarked for deposit into the Social Security Trust Fund, this would provide additional impact toward making the total program viable.

Although this recommendation is not high on our list of potential solutions, we are keenly aware of the unpopular nature of this recommendation. However, as we pointed out previously, we are seeking to explore all possible avenues of potential solutions to the problem and offer it as an additional approach for your consideration.

Recommendation 3.—Originally, 97% of all workers paid Social Security taxes on their full wages; today, only 85% pay on their full wages. The wage base should be gradually increased to establish a 90 percent ratio of employees contributing on their full wages. This will immediately generate additional premium income and will only increase future liabilities by a small amount due to "decoupling" and establishing replacement ratios.

Consistent with our first recommendation, we recommend a wage base increase for both employers and employees. However, we note that the administration's proposal would place a disproportionate burden on employers, with gradual removal of the ceiling until the full wage base is taxable in 1981. We wish to note here our objection to this proposal in its entirety, from both a fiscal inequity point of view as well as its departure from the current concept of equal sharing. Additionally, we believe that a gradual restoration of a 90% participation ratio is our minimum expectation. We believe this is an important objective which should be incorporated in any wage base proposal.

Recommendation 4.—Correct the present method of indexing benefits. The benefit formula introduced in 1972 should be "decoupled" to avoid the erratic and irresponsible increases in benefits this causes. Congress has been aware of the need for this but has not acted to make the necessary correction. It has been suggested that the system be modified so as to maintain a planned, constant and predictable relationship between benefit levels and preretirement earnings on which the benefits are based. Modifications of the benefit structure in this way holds a great deal of promise for helping to deal with the long range financial deficit in the program.

"Decoupling" would require redesigning the "automatic increase" provision to eliminate the double-barreled effect. This could be done by keeping the CPI increases for benefits after retirement, but by changing increasing benefits before retirement only in proportion to changes in covered wages over one's career; or by allowing post-retirement benefit increases based on productivity increases (wage increase minus price increase) instead of CPI increases; or by establishing a maximum post-retirement increase, i.e., equivalent to replacement ratio; or by eliminating this provision totally and asking the Trustees to review possible post-retirement increases each two years and make recommendations to Congress.

Our recommendation for decoupling supports the proposal made by the administration in this area.

Recommendation 5.—The present replacement ratio of benefits to taxable wages is approximately 60 percent for low-income, 40 percent for middle-income and 30 percent for high-income. By establishing the present ratio as a maximum

post-retirement benefit, we would simplify communications and calculations related to individuals' retirement planning and avoid the projected long-term possibility of benefits exceeding 100% of post-retirement income.

Recommendation 6.—The normal retirement age could be increased to 67 or 68. This would force better utilization of one of our country's greatest assets—experience—while having a very positive impact on the cost problem of our Social Security system.

By implementing this change, 30 to 40 years from now, it could always be canceled if demographics and/or funding changes allowed.

Recommendation 7.—Requiring a study of the actuarial assumptions and projections every five years and the formal reporting of the study results to Congress would prevent sudden "surprises" such as we've recently experienced.

Recommendation 8.—Coverage should be required of all federal employees and employees in other groups not presently covered. Many retired federal employees and others now qualify for coverage based on a minimal worktime in a second job. This results in a windfall of benefits which exceeds in most cases by a considerable amount the contributions made. This comprises a significant burden on the program.

Recommendation 9.—Financing the Social Security system by the application of funds from the general revenues should be avoided. Costs of the program should be borne by workers in covered employment. The application of universal coverage would reduce the tendency of large segments of the population to receive a windfall in benefits. Benefits should remain on an earnings related basis, and elements should not be built into the program which would move it in the direction of becoming simply another welfare program. Also, it should not be subject to budgetary delays and pressures which are experienced by programs which are supported from the general revenues.

Recommendation 10.—Although we are against the concept of funding from general revenues, if it is determined that it is absolutely imperative for the solvency of the system, we recommend that all non-retirement benefits be funded from general revenues, such as disability, survivor, Medicare, Medicaid, and supplemental income benefits. These tend to fall more into a "welfare classification" and should be treated and administered as such.

Additionally, we are not in favor of shifting funds from one account to another as proposed by the Administration. Shifting funds from one account to another has historically led to budget problems for the local and national governments who have attempted to use this approach as a solution to financial crises. Shifting of funds would also tend to blur the costs of the individual segments of the existing programs, thus making it more difficult to accurately project cost increases and to hold the proper authorities accountable for the distribution of funds.

Before closing, we would also like to briefly comment on recommendations made by the Administration which were not included in our recommendations.

1. *The restoration of the OASDI tax rate for the self-employed to the traditional level of one and one-half times the rate for employees.*

We fully agree with this recommendation.

2. *The institution of a new eligibility test to determine whether or not an individual may receive dependent's benefits to conform to Supreme Court Decisions regarding equal treatment of men and women.*

Based on the Supreme Court decisions, we are in agreement with this recommendation.

3. *The temporary use of counter-cyclical general revenues to be deposited in the OASDI and Hospital Insurance trust funds.*

Once again, as we have previously stated, we do not support conceptually the use of general revenues for specific program expenditures. However, we have suggested, as a last resort, the use of general funds for non-retirement benefits. We believe this recommendation would supply a permanent solution to the problem of combining welfare payments into what is publicly viewed as a retirement program. Although the Administration states that this is both a "temporary solution" and one that would be utilized only when "unemployment exceeded 6%", we do not believe that this proposal would really solve the problem. In either case, the use of general revenues will increase the tax burden on all citizens. Therefore, we feel that welfare programs should be funded from general revenues instead of as a part of the Social Security system.

CONCLUSION

We realize that massive changes to the Social Security system cannot be implemented at one point in time. To meet our commitments to our present retirees will require a gradual phasing in of many of the needed changes. We are also aware of the political, social and economic problems involved with changes of this nature. But when the price of inaction is to jeopardize the retirement income of most Americans and to threaten our whole economic system, we believe that action must be taken immediately by legislators and concerned citizens. We believe this will require responsible leaders representing business, labor and government to cooperate in adopting the changes needed to assure the integrity of the Social Security system.

ASPA and its members are ready to do whatever we can to contribute to the solution of our present Social Security problems.

Thank you for permitting us this opportunity to testify before this committee.

STATEMENT OF HON. LYNN CUTLER, SUPERVISOR, BLACK HAWK COUNTY, IOWA, ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES

Mr. Chairman, members of the committee, good afternoon. I am Supervisor Lynn Cutler of Black Hawk County, Iowa, representing the National Association of Counties (NACo) [1] where I am the national chairperson for social services. In that capacity, I represent both the Welfare and Social Services Policy Steering Committee and its affiliate, the National Association of County Welfare Directors, who administer the social services programs that are the subject of these hearings. On behalf of those groups, I am happy to testify in support of H.R. 7200, Public Assistance Amendments of 1977.

I want to commend this committee for your prompt consideration in addressing some of the funding and policy problems of the present title XX, title IV-A and title IV-B programs, as proposed in H.R. 7200.

The essence of my remarks is that additional funding for social services must be provided and that counties must have maximum flexibility in providing the services needed in local communities, within the available funds. I will also address some of the policy issues for social services and the specialized child welfare services, including the need for adoption subsidy.

First, title XX. NACo's position on this matter is that the $2.5 billion ceiling must be increased to halt the erosion of services that has been occurring due to inadequate funding; and that the authorization must be increased annually based on increases in the cost of living.

While we commend the $200 million permanent increase, this amount falls short of the full $1 billion increase we need for social services, and it must be considered a minimum. The new ceiling level of $2.7 billion established by making the $200 million increase permanent will not allow for expansion or buy new services. It will permit us to maintain the existing level of services and prevent further cutbacks in services to the needy. Without the cost of living adjustment provision, there is no assurance that adequate services can continue to be maintained.

NACo opposes the earmarking of these increased funds for child day care. As I indicated a few minutes ago, maximum flexibility is needed in the counties to administer services that fit the needs of our communities. Many States and counties are up to standard in day care provision and they require additional funds for other needed services. Earmarking the new funds for day care just penalizes those jurisdictions for having complied with Federal requirements. As a long-time day care advocate, I hasten to add that States with inadequate day care programs should be required to upgrade services in that area. This can

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[1] NACo is the only national organization representing county government in America. Its membership includes urban, suburban, and rural counties joined together for the common purpose of strengthening county government to meet the needs of all Americans. By virtue of a county's membership, all its elected and appointed officials become participants in an organization dedicated to the following goals: Improving county government; serving as the national spokesman for county government; acting as a liaison between the nation's counties and other levels of government; and achieving public understanding of the role of counties in the federal system.

be done effectively through regulation and monitoring by HEW of the day care standards rather than by legislative earmarking of the funds. Furthermore, earmarking of funds for any specific service or standard is contrary to the intent of the title XX law, which was to permit local government to deploy their share of social services dollars to those services most suited to their jurisdiction; within the broad guidelines of self-support, self-sufficiency, protection, and enabling persons to choose home care over institution. It's a good law, and we'd like to insure its integrity with adequate funding and by not earmarking.

Next, the title IV-B child welfare services. NACo supports the House recommendation for the full $266 million authorization, and the conversion to an entitlement program. NACo also supports the emphasis on services to prevent foster care and to provide alternatives to indefinite or "limbo" foster placement of kids. We support the restriction of funds for foster care maintenance payments.

The increased child welfare funding does not in any way decrease or offset the need for title XX services money. It does, however, put some teeth and meaning into a program that is not now very well-developed in most places in the Nation. The traditional low level of funding for the title IV-B services described in the law has negated any really effective use of the program to prevent or reduce the incidence of foster care. In many States and Counties, the IV-B funds have been used to pay maintenance costs of foster care.

Title XX services have come to be focused on the needs of the elderly, costly day care, homemaker services, and employment services, to the exclusion of the important specialized services addressed in title IV-B. This is understandable, given the limited funding base and the title XX goals of self support and self-sufficiency. Different goals and services are necessary for children at risk of foster care. There is no way the current title XX program can carry the needed services to prevent foster care and reunify families—so title IV-B needs its own funding.

Secretary Califano's proposal to limit new child welfare funds to $63 million until specific requirements are met, is unworkable. It triggers the classic catch-22 because $63 million isn't enough to develop the required services across the nation and if they aren't developed, the additional $147 million will be withheld. I hope that your committee will authorize the full $266 million.

Let me add a cautionary note about the level of funding and the imposition of standards and accountability: Services to provide alternatives to foster care can be very costly; and $266 million for a whole nation isn't very much. Proposed requirements for the use of the additional funds should be examined carefully to be sure that some one requirement doesn't eat up all the money. Once again, flexibility at the local level in use of the funds should be combined with strong Federal guidelines to provide a workable program. These Federal guidelines for child welfare services should be of a general and flexible nature to allow for services program development suited to community needs, but with safeguards to ensure that the new funding is directed at services to prevent foster case and to reconstitute families.

A few additional comments for the IV-B child welfare services increase:

(A) Like title XX, cost of living adjustment should be built in. I have pointed out that preventive and reconstitution services are costly, although very cost-effective in the long run. A normal cost of living increase rate of 5 percent will reduce the buying power of the $209 million fund by more than $10 million per year.

(B) NACo supports matching for IV-B at the same rate as title XX.

(C) To provide viable alternatives to foster care and adequate child welfare services, increased emphasis on training of staff and foster parents is needed. Increased training funds should be made available outside the closed end appropriations for title XX and title IV-B.

Adoption subsidy.—NACo supports establishing federal adoption subsidy and services to promote adoption where appropriate. Limiting the subsidy to one year as in H.R. 7200 is unlikely to encourage many suitable low income families to adopt hard to place children. A longer period, perhaps to maturity, is needed.

If an income test for adopting parents is used, it should be reasonable and simple to administer. It should not preclude families with middle to comfortable incomes from adopting.

Voluntary foster care.—NACo supports federal financial participation for voluntary foster care under title IV-A. The need to open up this funding is closely related to the child welfare and adoption issues. The Federal requirement for judicial determination of foster care in order to get Federal funding has created a system of processing voluntary placements through the courts for the sole purpose of securing Federal matching.

There are many situations that clearly call for a substitute foster home arrangement, for which court intervention would be patently foolish, and which extend for good reason beyond the 14-day "emergency shelter" period that is federally matchable.

An example is the child whose AFDC mother is hospitalized temporarily but longer than the federally defined "shelter" period. He was eligible for Federal matching at home on AFDC; eligible for Federal matching for 2 weeks of shelter care; ineligible for the intervening weeks or months until mother returns home, unless we go to court to have a judge tell us (a) that the mother and relatives are unable to care for him, and (b) that he has to be in a foster home awhile longer. Then we can claim Federal matching.

Use of the courts in this way is a disservice to the social agencies and the children and parents, especially when families are cooperating in the placement. and, of course, it adds court costs and wastes legal resources.

The necessary safeguards to prevent its abuse can come through Federal standard setting such as requiring regular and thorough administrative reviews of voluntary placements that extend beyond a given period. These, like the decision for placement, can best be handled by our trained social work staff. Rubber-stamping by the legal profession of these decisions where court protection is not required, is wasteful and inequitable.

Secretary Califano proposes to permit open ended matching for voluntary foster care, but would require a court or quasi-judicial review within three months. We have already pointed out that not all children in foster care require or can benefit from costly court intervention. To reconcile the differences between the HEW provision and those of H.R. 7200, we suggest that guidelines be supplied for adequate administrative review of voluntary foster care, reserving judicial review for cases that require the protection of the court.

Child support.—NACo supports continuing federal matching for child support collection services to nonwelfare families. The requirement of H.R. 7200 that requires fee charging unless payment of the fee would make the family eligible for AFDC, would be costly and complex to administer. This is because counties would have to determine eligibility for AFDC, not a simple process, in order to assess the $20 fee, for families not otherwise applying for welfare.

S. 1782.—Senator Moynihan's bill to provide $1 billion in fiscal relief to States and counties for fiscal year 1978 AFDC costs, is certainly of interest to counties. In other public statements we have said that fiscal relief should not be sacrificed to balancing the Federal budget, nor wait until major welfare reform is in place. So of course we support immediate fiscal relief, especially the provision of the bill that requires states to pass on to counties their proportionate share of the money.

However, I want to stress that fiscal relief for AFDC costs is not a substitute for the adoption subsidy, child welfare foster care services, or title XX social services that H.R. 7200 addresses. We need both. Therefore, I suggest that S. 1782 not be amended into H.R. 7200 unless there is clear provision for funding it over and above the social services provisions of H.R. 7200.

I thank you, Mr. Chairman and members, for the opportunity to present the counties views before this committee, and I will be glad to answer questions.

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES,
New York, N.Y., July 8, 1977.

Mr. MICHAEL STERN,
Staff Director, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. STERN: On page 56 of your "Staff Data and Materials Relating to Social Security Financing," there is reference to proposals made by the American Council of Life Insurance and the National Association of Manufacturers

to "maintain (Social Security) replacement ratios at a level 10 percent below the current levels."

For the record and for your information, the New York Chamber of Commerce and Industry also made such a recommendation in July 1976. (See my testimony on behalf of the New York Chamber as reproduced on page 140 of "Decoupling the Social Security Benefit Structure," Hearings before the Subcommittee on Social Security, Committee on Ways and Means, United States House of Representatives, U.S. Government Printing Office, Washington, 1976.)

Very truly yours,

BERNARD CLYMAN.

STATEMENT SUBMITTED BY THOMAS E. WOOD FOR HEWITT ASSOCIATES

Suggested Changes in the Social Security Structure

INTRODUCTION

Various proposals have been made to remedy the financial problems facing the Social Security system. In 1976, the Congress charged the Hsiao Panel of Consultants with responsibility for recommending revisions in the Social Security benefit structure. After lengthy consideration of alternative benefit formulae, the team of actuaries and economists concluded that a modified benefit formula indexed to changes in prices would produce relatively level expenditures into the next decade. Robert Meyers, an acknowledged Social Security expert and its former Chief Actuary, has suggested a new dynamic benefit formula, based on wage-indexing, but adjusted to a 10% lower benefit level. Such diverse interest groups as the Democratic Study Group, the AFL–CIO, two national senior citizens groups, and the National Association of Manufacturers have concentrated on various means of "decoupling" the present system.

Recently, the Carter Administration advanced a comprehensive eight-part program for bringing Social Security income and outgo into balance. The Carter proposal represents a hybrid position, combining a number of alternative solutions. The program would decouple the present system, and at the same time, provide additional sources of revenue through a combination of increased payroll taxes, general revenues, and a shifting of funds between various segments of the Social Security trust funds.

To date, the various alternative proposals have concentrated on solving the short term problems facing the present system. Missing from each is consideration of the broad public policy issue of what should be the role of Social Security in providing retirement income. The purpose of this paper is to focus on this issue. The paper explores the major problems facing the current system, outlines the characteristics of a program that would correct those problems and meet society's needs, and presents specifications for such a program.

PROBLEMS IN THE CURRENT SYSTEM

In 1972, Congress enacted far-reaching changes in the Social Security system. Most important for the future were the provisions which automatically coupled benefit amounts to changes in the Consumer Price Index and coupled the maximum wage base to changes in average covered wages. Economic and demographic changes that were unforeseen when this current system was designed have caused several problems. It may be helpful to focus on each of these before considering an alternative plan.

Rising benefit levels

Originally, indexing had been supported by many persons because they felt that automatic adjustments would guarantee benefit adequacy without the necessity of amendments, and Congress would be discouraged from passing "ad hoc" benefit increases which exceeded the rise in the cost of living. Unfortunately, the actuarial assumptions used in estimating the effects of the 1972 Amendments were based on wage and price experience for the period 1950–70. These assumptions soon proved to be unrealistic. Almost before it started rolling, the indexing system was subjected to a surge of high inflation combined with the deepest economic slump since the Depression of the 1930's.

Under the automatic indexing provisions, the percentage increase in benefits triggered by a rise in the CPI applies not only to benefits in current-payment status, but also to the percentage components of the multi-step formula that determines the ultimate benefits of active employees. In addition, the ultimate benefits of active employees also rise with wage increases. The result is an instability in the replacement ratio—the ratio that the benefit bears to the worker's taxable earnings in the year prior to his retirement, death or disability. During periods when inflation is high and gains in earnings barely keep up with price increases, replacement ratios will drift upward. When gains in earnings are high and inflation is controlled, the replacement ratios will remain stable or even drift downward. Because of the economic changes we have experienced recently, the replacement ratio for the median wage earner has climbed from 38 percent in 1972 to 44 percent in 1976.

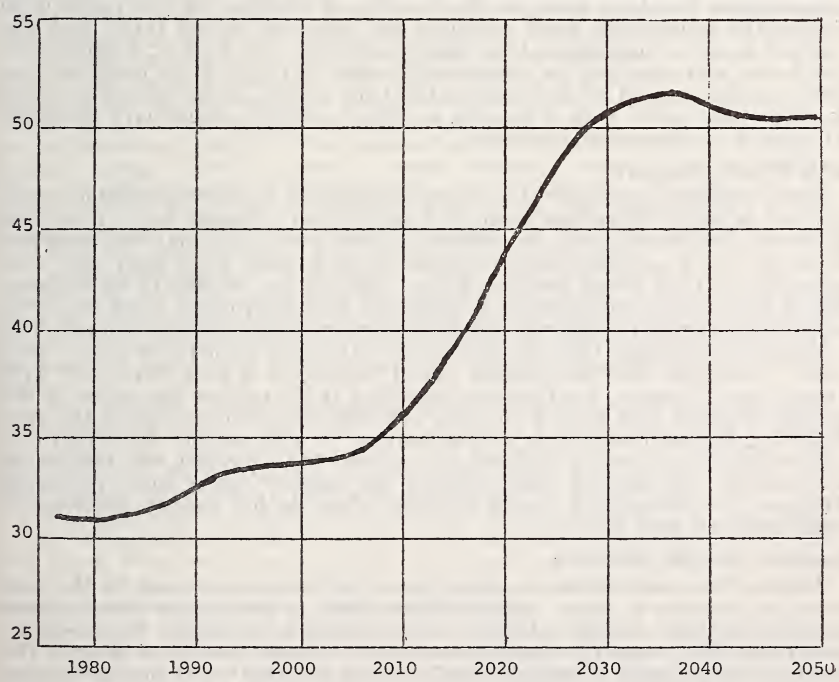
Rising costs

Under the economic conditions expected in the future, the current automatic indexing will lead to higher benefit levels, which will impose a large cost burden on employees and employers. However, a more serious cost problem results from expected demographic changes. At the present time, there are about three workers covered under Social Security for every one beneficiary. Around the year 2010, this ratio will begin to change drastically, and by the year 2030 will be down to two workers for each beneficiary. The chart on the following page shows the change in the ratio from now to the year 2050. It was prepared by the Social Security Actuary based on reasonable assumptions of population growth and labor force participation rates.

OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM

PROJECTED BENEFICIARIES PER HUNDRED COVERED WORKERS

1976-2050



This change in the ratio of covered workers to beneficiaries will lead to a need for higher taxes. With fewer workers paying the costs, each must absorb a greater portion of the burden.

Social Security Administration actuaries have projected future expenditures under the current program as a percentage of covered compensation. The figures below show the total costs, and also break out the portion of the expenditure that is due to rising benefit levels (column (5)).

[In percent]

Calendar year (1)	Expenditures (2)	Tax rate in law (3)	Excess of expenditures over taxes (4)	Portion of excess col. (4) attributable to increase in replacement ratios (5)	Tax rate needed if current replacement ratios are maintained (6)
1977	10.91	9.90	1.01	0.00	10.91
1980	10.80	9.90	.90	−.03	10.80
1990	12.39	9.90	2.49	.20	12.19
2000	13.91	9.90	4.01	.97	12.94
2010	16.57	9.90	6.67	2.46	14.11
2020	21.64	11.90	9.74	4.54	17.10
2030	26.02	11.90	14.12	6.62	19.40
2040	26.67	11.90	14.77	7.76	18.91
2050	26.93	11.90	15.03	8.64	18.29

As the figures indicate, even if current benefit levels are maintained, tax rates would need to rise from the current 9.9 percent to 19.4 percent by 2030 because of the demographic changes. With such large increases necessary, much consideration has been given to the question of whether we can continue to finance the system with equal employee and employer payroll taxes. And, the problem is more complicated than merely providing one level of financing for the future and selecting the appropriate source of funds. Since changing proportions of active and retired workers affect the amount of contributions needed to support any given level of benefits, an effective solution must have flexibility to respond to demographic changes.

Loss of public support

One result of the publicity given to the problems of the current system is that people are beginning to lose faith in Social Security. Benefit levels cannot be predicted and future costs are unknown. People are afraid that they will pay taxes for years and then receive nothing at retirement. Some state and local governments have either dropped out or explored the possibility of dropping out of the system. Editorials have suggested that individuals could do better on their own or that companies could offer better private plans at a lower cost.

Studies have shown that the accusation that Social Security is not a "good deal" is not true. For most people, Social Security is a good buy—even with rising taxes. However, what is most important is the public's perception of the system. Congress may look at financial problems that occur only after the year 2000 and dismiss them. Such a time horizon is well beyond the concern of current legislators. But, it is doubtful if workers in our society will feel secure unless there are answers which protect the system during their remaining lifetimes. If a person now age 30 will live to age 80, his concern stretches almost until the year 2030.

Inability to fulfill dual roles

Many of the problems in the Social Security system are caused by the dual roles the program is trying to fulfill. The system is designed to provide benefits that are both socially adequate and individually equitable. The need for social adequacy is met by weighting the benefit formula heavily in favor of the low paid, by providing a spouse's benefit, and by granting "fully insured" status for death and disability benefits after only six quarters of coverage. The value

of these benefits relative to the payroll taxes paid by the insured employee and his employer is much greater than the value received by many other workers.

The objective of offering individual equity is met with the wage-related benefit formula and the separate payroll tax system. There is an incremental benefit on higher pay so that those who make the greatest contribution receive the highest benefit. Also, Social Security does not require the means test of welfare programs. Those who pay taxes are guaranteed a benefit when they retire.

The problem that has arisen is that the current payroll tax structure cannot afford to support both parts of the system. As the benefits needed for social adequacy increase, taxes must increase. But, the regressive payroll tax is a poor vehicle for redistribution of income. Those who need the benefits most are burdened most heavily by the tax. On the other side, there is also difficulty in meeting the objective of individual equity. As higher taxes are needed to meet the costs of social adequacy, the incremental benefit received for paying the higher taxes must be decreased.

CHARACTERISTICS OF AN IMPROVED PROGRAM

Most of the alternatives that have been suggested for the Social Security system deal only with the problems facing us in the remainder of the twentieth century, or only with a portion of the total program. If we are to find effective long-term answers to all the problems, we must first consider the characteristics that the solution—or new program—must have in terms of both benefit design and financing mechanisms. Following are some suggestions.

A. Benefit design criteria

1. Social adequacy.—The benefit level should be adequate to provide all necessities of post-retirement living for the worker covered by OASDI for most or all of his working career without supplementation by personal savings or significant private pension benefits. If the OASDI program fails to reach this level of adequacy, other forms of public assistance must operate concurrently. These other forms generally impose a means test to qualify, a requirement thoroughly inconsistent with the basic concept of the Social Security program.

This criterion assumes that private pensions are not going to spread to the entire work force. In the decade of the 1950's, rapid growth of private plans occurred, and by 1960 coverage was in effect for about half the workers in the private sector. Since then, progress has been much slower. It seems likely that tax incentives will continue the spread of private plans slowly, but coverage is probably going to fall far short of being universal. And it is least likely to occur in industries where small employers predominate and wages are generally low. Therefore, Social Security must accept the responsibility of providing through OASDI the amount necessary to maintain necessities after retirement for the workers not covered by private pensions.

2. Individual equity.—The benefit formula must also maintain a degree of equity among covered workers. The individual who earns more and contributes more to OASDI during his career should receive a higher benefit than one who earns and contributes less. A corollary principle is that a worker should have his benefit based on the same earnings on which his contributions are determined.

3. Benefit limits.—OASDI should not provide benefits beyond some maximum. Some moderate level of pay is all that should be covered. The level might be set at the point where three-quarters of all wage earners have their full earnings subject to the system. To go beyond that point is to provide unnecessary coverage and to require an unnecessary allocation of federal funds.

4. Predictability of benefits.—The amount of benefits should be predictable so that it can be counted on by workers and employers sponsoring private pension plans. Since wage levels cannot be forecast in advance, OASDI benefits should be predictable not in dollar terms, but as a percentage of pay to be replaced in event of retirement, death or disability.

This need is not filled by indexing earned benefit credits to changes in prices or wages. In indexing, an element of unpredictability remains. The most appropriate criterion is average earnings of each worker in some period of years preceding receipt of benefits. This average earnings level would represent a reasonable definition of his or her living standard.

5. No discrimination in favor of married workers.—The benefit formula should not discriminate in favor of workers who are married. The spouse's benefit, originally adopted when labor force participation among women was much less extensive than today, no longer seems appropriate in a society where the majority of women work. It may be appropriate for all persons past retirement age to have a payment to assure income adequacy. But it does not seem appropriate to have such a payment from an earnings related OASDI system of pay replacement.

B. Financing criteria

1. Flexibility.—The financing system should be flexible and capable of working permanently. As economic conditions and demographic characteristics change, the financing structure should be able to adjust to bring in the needed amount of funds to support current benefit requirements. At the same time, the system should maintain only a limited reserve. In fact, building a large reserve to obtain actuarial soundness would be detrimental to the economy by siphoning funds away from the private sector.

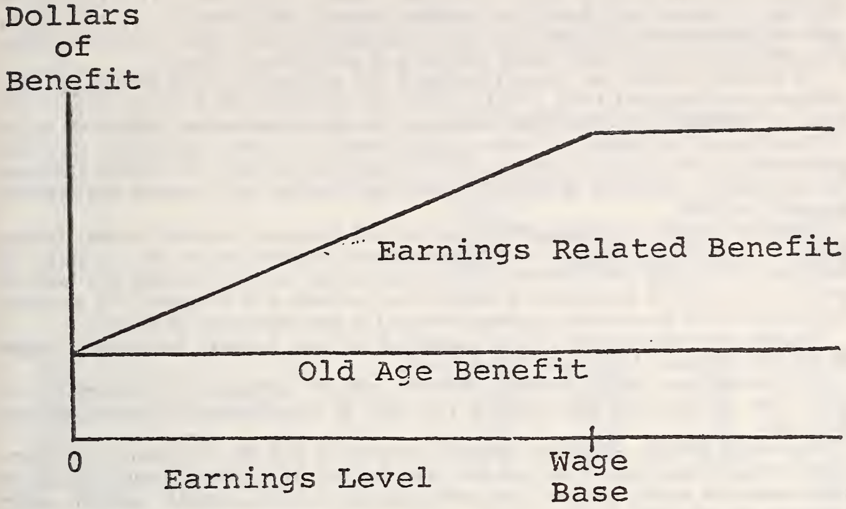
2. Separate tax system for wage-related benefits.—The wage-related benefit should be supported by a separate tax system. Contributions should be based on earnings and should be paid equally by employers and workers. It is not necessary for the entire benefit to be wage-related and that portion which is not need not be financed by payroll taxes. But the benefit which is related to earnings should continue to have a separate financing base to assure workers that their future security is not threatened or subject to periodic legislative approval for allocating general revenues to the OASDI program.

3. Universal coverage.—There should be universal coverage under OASDI. The present exemptions from required coverage for employees of certain nonprofit organizations should be eliminated. The permissible exemptions for employees of state and local governments should also be discontinued if there is no constitutional prohibition to required coverage. Employees of the federal government should be covered by OASDI and the benefits under their retirement plans should be integrated with the universal OASDI program. Attaining universal coverage will eliminate overlapping of benefits and unintended windfalls to persons who serve only part of their careers in OASDI covered employment.

SPECIFICATIONS FOR A PROPOSED STRUCTURE FOR SOCIAL SECURITY

The preceding characteristics for a permanent solution to Social Security's problems suggest a revamped benefit and financing structure. Conceptually, the best solution might involve a two-tiered system composed of a flat Old Age Benefit payable to all persons past retirement age and an earnings-related OASDI program which is no longer weighted for low pay levels. The two together might provide benefits similar, although somewhat higher, than under present law. The earnings-related benefit, no longer burdened with high benefits at low pay levels, could be related proportionately to average earnings in the highest paid ten years of work and still be permanently supported by equal contributions from employers and workers. The Old Age Benefit would be paid for by a combination of payroll taxes and general revenues.

The following diagram represents how the structure would look for a single retiree. If there were also a nonworking spouse, there would be two Old Age Benefits paid instead of one.



Following is an outline of the principal features of this proposal, describing major benefit provisions and financing mechanisms.

A. Old age benefit

Concept.—A payment to all persons upon attaining a specified age, whether or not there is a previous work history. Similar to the Old Age Benefit in Canada.

Effective Date.—Applies to all persons retiring on or after January 1, 1978.

Coverage.—All U.S. citizens, whether or not they have a previous work history.

Amount of benefit.—Initially $150 per person per month. Payable monthly. To be increased in each January based on changes in Elderly Persons Consumer Price Index, an index to be prepared by the Bureau of Labor Statistics based on changes in prices for a market basket of goods typically purchased for an elderly couple.

Retirement age.—Full Old Age Benefit paid if payment commences at or after age 65. Reduced one-fifteenth per year if commencement occurs at age 62 to 64.

Tax treatment.—Benefit included in taxable income as received. Not subject to 50 percent ceiling on personal service income. After-tax value of benefit thus declines as amount of other taxable income rises.

Effect of continued earnings.—No reduction in benefits made on account of earnings up to one-third of current wage base maximum. Thereafter, benefit reduced $1 for each $2 of earnings.

Benefits in event of death or disability.—None.

B. Earnings-related benefit

Concept.—A benefit related to covered earnings in the highest paid 10 years prior to retirement, financed by equal payroll taxes on employers and workers.

Effective date.—Applies to all benefits that commence on or after January 1, 1978.

Coverage.—All persons with qualifying wage records under OASDI. To be eligible for death and disability benefits, present requirements are continued, with as little as six quarters of current coverage required. For retirement benefits, permanent coverage of forty quarters of coverage required.

An attempt should be made to extend the system to cover groups of employees now excluded from OASDI, such as employees of Federal, State and local governments. If successful, problems of gaps in protection and overlapping of benefits will disappear. If some groups remain excluded, payment otherwise produced by the benefit formula to be multiplied by ratio of actual quarters of coverage to quarters of potential coverage, taking into account permissible dropout periods.

Primary benefit formula.—33⅓ percent of average covered wages during highest reported 10 years of coverage, reduced proportionately for coverage of less than 35 years. For persons with increases in earnings during the last 10 years of work of 4 percent to 6 percent per annum, this formula will produce 25 percent to 27 percent of earnings during the last full year of work.

Benefits payable monthly. To be increased in each January based on changes in Elderly Persons Consumer Price Index.

Retirement age.—Full Primary Benefit paid if payment commences at or after age 65. Reduced one-fifteenth per year if commencement occurs at age 62 to 64.

Disability benefit.—Primary Benefit plus, until age 65, supplementary payment equal to amount of current Old Age Benefit. If eligible dependents, same allowances as under present program related to total monthly benefit being received by disabled worker.

Death benefit.—If over age 65 or under 65 with dependent children, spouse received 100 percent of worker's Primary Benefit. Each eligible child up to two receives same amount.

Covered wages.—All earnings up to wage base maximum, initially set at $16,500 and increasing each January in accordance with changes in average reported earnings in the first quarter of the preceding year compared to first quarter of the year earlier.

Contributions.—Equal taxes on earning by employers and workers equal to the same percentages as contained in the present law, less the portion of that total allocated to Medicare program. For employer and worker, these percentages are:

Year:	Percent of covered wages
1978 to 1980	6.05
1981 to 1985	6.30
1986 to 2010	6.45
2011 and after	7.45

Tax treatment.—Same as under present law, i.e., employee contributions are not tax deductible when made, but employer contributions are. Benefits are received on tax-free basis.

Effect of continued earnings.—No reduction in benefits made on amount of earnings up to one-third of current wage base maximum. Thereafter, benefit reduced $1 for each $2 of earnings.

C. Financing mechanism

Concept.—The earnings-related benefit should be financed by payroll taxes alone, equally paid by worker and employer. Such separate financing assures future stability of the system and eliminates concern among citizens about the future ability of the program to continue payments. For the payroll tax to be able to support the earnings-related benefit, there will need to be a shift at some future date of the cost for the Medicare program from the payroll tax to general revenues.

The excess of contributions received from the payroll tax over the amount needed to pay benefits and maintain appropriate reserves under the earnings-related program are to be applied to meet the costs of the Old Age Benefit with excess costs being financed from general revenues.

Earnings-related benefit.—As a rough estimate, the proposed earnings-related benefit can be financed at a cost equal to three-fourths the cost of the present OASDI program, assuming no future increase in pay replacement rates. Based on the 1977 Report of the Social Security Actuary, Table 1 shows an estimate

of the income and outgo from the OASDI fund, expressed as percentages of covered payroll.

Old age benefit.—This benefit shall be paid from a Social Security fund separate from OASDI. Part of the contributions come from the excess of contributions to OASDI over the amount needed to pay earnings related benefits and maintain appropriate reserves. The balance of costs shall be paid from general revenues by means of Congressional appropriation.

TABLE 1.—ROUGH ESTIMATE OF COST TO FINANCE EARNINGS RELATED BENEFIT [1]

[In percent]

(1)	Present OASDI if pay replacement constant [2] (2)	New earnings related benefit [3] (3)	Payroll tax in present law [4] (4)	Excess applied to old-age benefit [5] (5)
Year:				
1980	10.83	8.12	9.90	1.78
1990	12.19	9.14	9.90	.76
2000	12.94	9.71	9.90	.19
2010	14.11	10.58	12.90	2.32
2020	17.10	12.83	14.90	2.07
2030	19.40	14.55	14.90	.35
2040	18.91	14.18	14.90	.72
2050	18.29	13.72	14.90	1.18

[1] Expressed as percentages of covered payroll.
[2] From 1977 Report of Social Security Actuary.
[3] Estimated as 75 percent of col. (2).
[4] As provided for in present law. Through the year 2000, the present rate for OASDI is used. Starting in the year 2010, the combined tax rate for OASI and hospital insurance is applied.
[5] Difference between cols (4) and (3).

WHAT THE PROPOSED SOCIAL SECURITY STRUCTURE ACCOMPLISHES

1. Initially, benefits under the proposed system are about equal to present benefit levels. (See table 2.)

2. Benefits are "decoupled," eliminating the movement toward higher pay replacement ratios and accompanying higher costs. Benefits will stay reasonably constant in the future as percentages of final average earnings.

3. Benefits can be predicted. The worker has a good idea of how much of his pay the system will replace. He can also count on the future financial stability of the fund providing earnings related benefits.

4. The earnings related benefit no longer includes nonworking spouse's benefits. This change eliminates one form of inequity among contributors.

5. It is no longer necessary for the formula for the earnings related benefits to be weighted in favor of lower pay levels. This permits greater equity among contributors.

6. The problem of disproportionately larger benefits for those in the system for only part of their careers is eliminated by the proportionate credit approach to computing benefits.

7. Benefits will remain adequate after commencement by being indexed to a special CPI for retired workers.

8. Weighting total benefits to assure adequacy for lower income persons is continued, but through a separate mechanism of a flat dollar benefit. Initially, the total benefit provided by the proposed program meets the requirements of the Low Budget for an Elderly Couple for a worker with final year's earnings of $4,900 and the Intermediate Budget for a worker with earnings of $12,800, assuming in both cases a non-working spouse also eligible for the Old Age Benefit.

9. The earnings related benefit can be financed indefinitely by equal payroll taxes paid by employers and workers. The necessary tax rates are those included in the present law.

10. General revenue financing is introduced, but it is specifically allocated to the Old Age Benefit. It seems more appropriate to use general revenues for that portion of the program which is designed to guarantee benefit adequacy than for the portion related to earnings.

11. Flexibility in financing is introduced. The contributions to the earnings related benefit that exceed the cost of that benefit are used to pay part of the costs for the Old Age Benefit. As demographic and economic factors change, the excess varies.

12. Benefits are reasonably predictable, simplifying the planning of private pensions and savings. Integration regulations governing how private plans coordinate with Social Security can be simplified and related to the amount of benefit received rather than to the presumed value of the entire program.

13. With pay replacement levels from Social Security held constant, the role of private pension plans will not be eliminated. Consideration should also be given to encouraging the use of Individual Retirement Accounts by liberalizing the requirements and increasing the allowable tax deduction.

TABLE 2.—COMPARISON OF ANNUAL RETIREMENT BENEFIT LEVELS—PRESENT VERSUS PROPOSED

	Worker only				Worker and spouse			
		Proposed benefit				Proposed benefit		
Final year's annual earnings	Present Benefit [1]	Old age Benefit	Earnings-related Benefit [2]	Total	Present Benefit	Old age Benefit	Earnings-related Benefit	Total
$6,000	$3,330	$1,800	$1,620	$3,420	$4,995	$3,600	$1,620	$5,220
$7,200	3,743	1,800	1,994	3,744	5,615	3,600	1,944	5,544
$8,400	4,156	1,800	2,268	4,068	6,234	3,600	2,268	5,868
$9,600	4,427	1,800	2,592	4,392	6,641	3,600	2,592	6,192
$10,800	4,698	1,800	2,916	4,716	7,047	3,600	2,916	6,516
$12,000	4,969	1,800	3,240	5,040	7,454	3,600	3,240	6,840
$13,200	5,083	1,800	3,564	5,364	7,624	3,600	3,564	7,164
$14,400	5,185	1,800	3,888	5,688	7,778	3,600	3,888	6,488
$15,600	5,244	1,800	4,212	6,012	6,866	3,600	4,212	7,812
$16,800	5,244	1,800	4,455	6,255	7,866	3,600	4,455	8,055

[1] Payable in 1977.
[2] Assuming 4 percent annual pay increase in last 10 yr of coverage.

ROLE FOR PRIVATE PENSIONS

The revised Social Security structure described in this paper is designed to provide benefit levels that will cover the necessities of post-retirement living. About 50 percent of the workers in the country are not covered by private pension plans, and many of these people are lower paid workers who probably have little personal savings at retirement. The revised Social Security system can meet the basic needs of this group. However, since there is a limit on the earnings covered by Social Security, private pensions must still supplement benefits for middle income workers and play a major role in meeting the needs of the higher paid worker. Two issues that should be considered, therefore, are (1) how should private pensions tie in with Social Security; and (2) can we extend private pension coverage?

Issue 1: How should private pensions tie in with Social Security?

Under the proposed structure, Social Security benefits will be reasonably predictable and will meet the basic needs of retirees. However, since private plans will continue to supplement Social Security for the middle income worker and replace some portion of the pay not covered for the high income worker, policy should be legislated governing total retirement income. We suggest four criteria be considered in developing this policy which would be substituted for the existing integration rulings.

1. Total retirement incomes from public and private plans should not exceed some specified maximum.

Total retirement incomes that exceed some maximum level, such as 100 percent of pre-retirement gross pay, are not socially desirable. Benefits beyond such a level cannot be justified on the basis of need.

2. Total retirement income should not be greater for high paid employees than for low paid employees.

Combined benefits from the public and private plans should not provide a greater percentage of pre-retirement gross pay for the high paid worker than is provided for the low paid worker.

3. Private plans should be allowed to integrate with the total Social Security benefit.

If we set policy governing total retirement incomes, it is necessary that private plans be allowed to consider total public plan benefits. If only a portion of Social Security is considered, total retirement income could exceed the specified maximum when full Social Security is added to the private plan benefit.

4. Coordination of public and private benefits should be on the basis of benefits received.

Current integration regulations are based on the presumed value of Social Security. However, as Social Security benefits rise, the value changes, and the regulations are immediately obsolete. Coordination based on actual benefits paid from Social Security would simplify the process and assure the appropriateness of benefit level. Furthermore, if we are to have a policy governing total income, it can be controlled only if the public and private systems are tied in on the basis of benefits.

Issue 2: Can we extend private pension coverage?

One objective of the Employee Retirement Income Security Act of 1974 was to extend private pension coverage to a greater proportion of the work force. One item aimed at meeting this objective was the provision allowing for the establishment of Individual Retirement Accounts, or IRA's.

IRA's can be established by any person who is not covered by a qualified pension or profit sharing plan offered by his or her employer. Low paid workers not covered by a private plan may find that the benefits provided by Social Security meet their needs. But, middle to higher income workers could be encouraged to supplement Social Security and meet their retirement income needs through the use of IRA's.

As we see it, three changes in the legislation and regulations governing IRA's should be considered to encourage their further use.

1. Increase the allowable tax deduction.

Currently, individuals can take a tax deduction of up to $1,500 for contributions to an IRA. To encourage greater savings for retirement, to promote interest among more people, and to promote interest among more banks and other institutions that can offer IRA's, this limit should be raised. It may be appropriate at this time to raise the limit to $7,500, the maximum deduction currently allowed for contributions to H.R. 10 or Keough plans. Also, the limit for both IRA's and H.R. 10 plans should be increased annually based on the same index used to raise the ERISA limits for qualified plans.

2. Allow employees to make up for years in which no contribution is made.

Many individuals may be ineligible to contribute to IRA's because they are covered by their employers' private plans. Yet, if they leave their employers before becoming vested, all accrued benefits are forfeited. These people should be allowed to make up for the lost benefits. The limits could be set in a manner similar to those governing tax sheltered annuities for persons at 501(c)(3) organizations, and contributions would also be subject to the ERISA limits.

3. Allow employers without qualified plans to make contributions to IRA's for their employees.

Many small employers may want to provide retirement benefits for their employees, but hesitate because of the administrative requirements. These employers should be allowed to make annual contributions to each employee's account based on a simple IRA contract with a bank or other institution. The provisions regulating these plans could be restrictive; contributions would be at the same rate as a percentage of earnings for all employees and within a certain range, vesting would be immediate, and provisions regarding withdrawal would remain as in the current law. To offset the lack of flexibility, companies would have few administrative requirements. The bank or other institution would handle all day-to-day administration such as benefit statements and retirements. The company would have no responsibility for terminated vested employees. No plan document would be required. And, only one annual report that included a trustee's statement would be needed to support the employer's tax deduction. A change of this type could encourage the spread of retirement plans to a significant portion of the work force now not covered.

STATEMENT OF THE U.S. INDUSTRIAL COUNCIL

The impending crisis in the Social Security System, with rapid depletion of trust funds and inadequate replinishment of those funds to meet the rising level of benefit payments, poses one of the most serious problems facing this or any other Congress.

The Social Security problem includes severe deficits for both the short range and the long term. According to the 1977 report of the Social Security Board of Trustes, the Old Age and Survivors Insurance Program (OASI) trust fund may run of money around 1983. The Trustees say the Disability Insurance (DI) trust fund is even nearer depletion and may be out of money as early as year after next.

The American people, and particularly those receiving OASI and DI benefits, have reason to be alarmed. For 1977, there is a gap of $8 billion between the cost of benefits and current revenues. Those who are now working, paying Social Security taxes, and looking forward to future benefits, have similar cause for concern, for the long range outlook is even worse than the problem immediately ahead. Actuarial estimates prepared for the next 75 years show that expenditures under the program as presently constituted will exceed expenditures at an average annual rate of $66 billion at present payroll levels.

Clearly, major reforms must be undertaken. Cosmetic treatment or political solutions which do not deal with the underlying causes of the Social Security crisis must not be tolerated.

The United States Industrial Council believes the first requisite for true reform of the Social Security System is that it be maintained as an insurance program and not be converted into a huge welfare or income transfer program. To deal with the short range deficit, it appears more income for the trust funds probably must be obtained from some source. For both the short and long range, the cost of Social Security benefits must be brought into balance with income so that the program is actuarily sound. Congress must remedy the mistake it made in providing for continually escalating benefits and relying for funds to meet sharply increased costs on actuarial estimates which proved to be unsound.

The Social Security program was set up on what was supposed to be an actuarily sound basis, so that during the period covered by actuarial estimates, income would cover cost of benefits and expenses of administering the program, with a small fraction of a percentage point in allowable variation. The present problem began when escalation was built into the program in the form of automatic increases in the taxable wage base with corresponding increases in benefit levels, plus automatic cost of living increases in benefits. Furthermore, instead of confining cost of living increases, based on the Consumer Price Index, to the benefits being received by retired persons, Congress enacted poorly conceived legislation providing for tieing both the wage base and benefits to the CPI, so-called double indexing.

The problem was brought to an acute stage by the economic downturn and unemployment which cut income from Social Security taxes, by inflated prices, and by underestimates of longevity and the decline in the birth rate.

In dealing with the Social Security problem, Congress must recognize (1) that there is a point beyond which Social Security tax increases, either by raises in the tax rate or increases in the taxable wage base, cannot go without doing serious damage to the economy, and (2) limitations must be placed on benefits and the proper ratio restored between average lifetime earnings and benefits.

When the Senate Finance Committee reported out legislation adding a cost of living escalator to the Social Security Act, the Committee said in its report accompanying the legislation it wished "to make clear its intention that the full cost (as estimated at the time the increase is promulgated) of each automatic increase is to be financed by additional taxes imposed at the same time that benefits are increased." Although this principle was incorporated in the bill as passed by the Senate, it is extremely unfortunate that it was dropped from the final version of the legislation. It would have helped to avoid the dilemma in which Congress now finds itself with regard to Social Security.

While for the short range, the Social Security program may need some kind of "quick fix" the United States Industrial Council is adamantly opposed to

the one proposed by the Carter Administration—transfer of general tax revenues to the Social Security trust funds. The Administration's rationale is that the general revenues would replace the Social Security taxes lost as a result of unemployment during the recession. Under its formula, $14 billion would be appropriated from general revenues for Social Security for the period 1978–80.

While the transfer of general funds to Social Security is referred to by Administration spokesmen and in the public press as "temporary," we consider the use of the work "temporary" to be misleading. The Senate Finance Committee staff study of Social Security Financing had this to say about the Administration's proposal for transfer of general revenue funds: "Although the Administration proposals are based on an assumption that the provision would become a permanent part of the Social Security financing plan, they suggest that it be enacted on a temporary basis. The Advisory Council on Social Security (to be appointed this year and to report at the end of 1978) would be charged with recommending whether such a provision should be a part of the permanent financing scheme."

The United States Industrial Council believes that if the use of general tax revenues to help finance Social Security benefits were started, it not only would become a permanent part of the program but would expand to provide ever increasing benefits. Freed from the restraints of having to impose higher and higher Social Security taxes and resulting public protests against such taxes, Congress would find it difficult to resist the temptation of following the politically popular course of voting more and more benefits.

In an interview published in U.S. News & World Report, Chairman Al Ullman of the House Ways and Means Committee responded to a question as to why he was reluctant to use general revenues to help finance Social Security as follows: "Because the concept of separate taxing and funding for Social Security gives it fiscal integrity. In other words, whenever you add a benefit, you have to add a tax to pay for it. If you start using general revenues, that discipline is lost. Going to general tax revenues would be a real fiasco—if you wanted to increase benefits, you could just increase the contribution from the general fund from zero today to 33 percent to 40 to 50 and on up. The discipline is gone."

We agree with those observations by Rep. Ullman and his further observation that, "People who get Social Security don't want to feel that they're taking funds from a welfare program. They like to feel they're taking funds from a system to which they have contributed and paid their fair share, and that they're getting it as a matter of right—not just a right that society owes them but a right they've earned."

It is important that Administration, Congress and the general public continuously bear in mind that there is no general fund in which to dip to get money for the Social Security program without either taking away from other programs or increasing the deficit by further borrowing. The federal government has for some time been spending more than it takes in. Even a paper transaction of transferring funds from general revenues to the Social Security trust funds would help to undermine the credit of the federal government.

The United States Industrial Council is opposed to the Administration's proposal for providing long range Social Security financing by removing the ceiling from the taxable wage base on which the employer pays taxes, while making only minor adjustment in the wage base on which the employee pays taxes. The concept of Social Security as an insurance-pension program whose cost is borne equally by employer and employee should be preserved.

The Administration's program is designed to close an $83 billion gap between income provided by the present financing system and its projected cost of benefit during the period 1978–82. It would close this gap by obtaining $56 billion in additional income and reduce the amount of income needed by $27 billion. The major part of the tax burden would be laid on the shoulders of employers, who would pay an additional $30 billion in Social Security taxes as a result of eliminating the wage base ceiling. Other sources of income for the period would be $4 billion from additional employee taxes, $7 billion from diverting Hospital Insurance taxes under the Social Security program to the OASI and DI trust funds, $1 billion from an increase in the self-employment tax rate, and $14 billion from an appropriation from general revenues.

HEW Secretary Joseph Califano stated in what must be rated one of the most absurd remarks of the year that employers could take the $30 billion out of profits. In some industries, profit margins are so slim the increased employee payroll taxes would drive many companies out of business. In others, accumulation of capital needed for modernization and expansion would be seriously curtailed. In some industries, unemployment would be increased when companies found it necessary to reduce the workforce because of increased labor costs. In most cases, the increased costs would have to be passed along to consumers in higher prices. The cumulative effect of all these things would do severe damage to the economy. It also would create a vicious cycle in which higher prices for goods and services would eat away the value of Social Security benefits.

The United States Industrial Council believes that the short range and long range deficits should be dealt with as part of the same problem and major reforms made in the whole system. To begin with, we believe that the method of computing benefits should be restructured to remove both cost of living increases and wage base increases from the formula used to determine entitlements during the earnings period—in other words, complete decoupling.

The USIC believes the evidence is clear that providing for automatic adjustments based on the CPI and automatic upward adjustments in the wage base are highly inflationary. They cause prices to drive up wages and wages to drive up prices in a never ending cycle.

We are opposed to the Administration's proposal that cost of living adjustments be eliminated but that wage indexing be used in the mechanism for determing benefit levels.

Wage indexing should not be used at all. Cost of living increases should be used for adjusting benefits only after retirement and we recommend that instead of cost of living increases being given automatically, increases should be determined by Congress after careful review of the program.

The inability of actuaries to make accurate projections for the indefinite future or for a 75-year period is demonstrated by the present plight of the Social Security Program. We believe that in lieu of provisions for automatic escalation of benefits, Congress should be forced to examine the program periodically and make adjustments if needed.

The USIC believes that trust funds should be maintained at levels adequate to provide reserves against periods of recession and high unemployment, and that Social Security be returned to a pay-in, pay-out, basis. We consider the Administration's proposal that trust funds be reduced from 50 percent of estimated needs for the following year to 35 percent because of its recommended access to funds from general revenues to be unsound.

While the steps we have recommended would go far to hold down the costs of benefits, it appears it probably will be necessary to increase Social Security income to bring it into balance with outgo. This being the case, due to the deterioration in the system brought on by actions by Congress in some cases and inaction in others to keep the system financially sound, it appears to us an increase in the tax rate would be the best of the possible choices. An immediate increase of 0.25 to 0.3 percent for both employers and employees appears to be in the range needed in another two years to keep the system in balance.

The USIC is opposed to increasing the taxable wage base. This shifts more of the tax burden to middle income wage earners and causes inequities among employers in professions and industries which have large proportions of highly paid workers.

There seems to be general agreement with the Administration's proposal that the tax rate on the self-employed be inreased from 7 percent to 7½ percent and we do not oppose it. We also support the Administration's proposal under which a wife, widow, husband, or widower would have to meet a test of dependency on the spouse in order to qualify for dependents or survivors benefits, at an estimated savings of $3 billion for the 1978–82 period.

The United States Industrial Council represents more than 4,000 business and industrial firms employing approximately 3,000,000 people. All of those represented in our membership, employers and employees, have a big stake in the restoration of the Social Security System to a sound basis. We hope this committee will give serious consideration to our recommendations.

Statement of Richard E. Carver, Mayor of Peoria, Ill. on Behalf of the National League of Cities

Mr. Chairman, members of the Committee, I am Richard Carver, Mayor of Peoria, Illinois, and Chairman of the National League of Cities' Effective Government Committee. I am here today on behalf of the National League of Cities and its 15,000 members.

With your permission, I would like to submit for the record, the NLC Policy Statement on Social Security. In summary, our National Municipal Policy requests that Congress leave intact the current provisions regarding local government entry or withdrawal from the Social Security System. Our policy further suggests that the Social Security system be restored to its original purpose—an insurance program financed by employer and employee contributions into a trust fund providing wage related benefits to workers as a matter of right; that there be no earnings penalty for retirees who choose to work; and that supplementary benefits be paid from an income support system.

I wish to speak to several of the issues related to the general problem of financing the Social Security system, and in particular to the Administration's proposals. The urgency and magnitude of the problem are well-enough known. More than 32 million people receive Social Security benefits totalling $6 billion per month. About 104 million people are covered by Social Security. Without changes, the trust funds will soon be exhausted, and a massive deficit will develop.

My comments as a city official are from two perspectives— as an employer and as an elected representative of the taxpayers of my community. State and local governments currently employ over 12 million individuals—about 70 percent of whom are covered by Social Security—and are paying around $9 billion annually in Social Security taxes. The direct interest of city governments in Social Security financing is evident from the cost perspective alone. At the same time, however, like you, city officials are elected representatives and must be concerned with the retirement well-being of all their citizens. Without adequate and equitable retirement benefits, urban residents will be forced to turn for help to the closest level of government, the provider of basic services in our federal system—local governments. For city governments then, the Social Security financing problem presents direct and indirect threats and as the payment of social security benefits requires a greater and greater share of the federal budget, less and less is available for other purposes. Given these concerns, I do not find the Administration's proposal for changes in the financing of the system at all adequate. Let me hasten to say that our current plight—created largely through inadvertence and unpredictability should make no one confident in his judgments about the future of the Social Security system.

Most generally, and most importantly, I am not satisfied that the Administration has gotten to the root of the problem. There is a need to ask questions about what is being financed before making important decisions about how to finance it. There is, most especially, a need to get back to first principles in the case of Social Security and ask what its purpose is, what its relationship is to other programs and activities—public and private—and whether or not it requires system-wide substantive changes. There is a need, one might say, for some "zero-based budget" analysis.

The Administration has quite reasonably sought to fulfill its campaign commitment to solve the short-term financing problem and to put the long-term financing on firmer footing. But in doing so, it has accepted the program as is and offers a set of tactics without a consideration or reconsideration of strategy and goals.

What about the tactics? The Administration proposes to dip into general funds for the payment of Social Security benefits. This would be done on only a limited basis—when unemployment rises above six percent—and is justified as a payment for loss of contributions from the payroll tax. These limitations it is argued, also limit the precedent for the use of general revenues. But the fact remains that it would be a precedent, in itself dependent on unpredictable conditions and, if expanded, unaccompanied by the basic rethinking of Social Security that would make one confident that any line could be held.

It would at the same time introduce a large, automatic economic stabilizer without consideration of its effects on the national economy or concern for the limits that would be placed on discretionary counter-cyclical policy. We might well want to spend general revenues for other purposes during a recession. In the case of unemployment compensation, the use of general revenues at least has the justification of a close connection with the problem to be addressed. Whereas, in the case of Social Security, the recourse to the general fund has more the appearance of a financial strategem.

Another of the tactics of the Administration's proposal would be to tax the employer on the full earnings of the employee. This would be done in three stages between now and 1981. This would, of course, be an immense mandated cost for state and local governments, increasing their costs over the four years by an estimated $3 billion. Local governments are not in a position to absorb yet another federally mandated cost at this time. We have yet to appreciate fully the fiscal impact on local government budgets of the recently extended unemployment insurance coverage of public employees.

As I mentioned earlier, city governments share the interest of other employers in some respects, most obviously in this case. Removing the wage-base ceiling for employers enables the Administration to claim that it has fulfilled its campaign promise of solving the Social Security problem without increasing the payroll tax rate. Employers should be forgiven if they see in this a measure of legerdemain. Without making basic changes in Social Security it is necessary to improvise. Since an increase in the wage base on which the employee pays a tax would require an increase in benefits which would worsen the financing problem, an alternative is to increase the employer wage base. Then, positing a surprise-free future and the proposed combination of recession dips into general funds and a reduced reserve, it is asserted that the employer's burden would be less than if the shortfall were met through ordinary increases in rate and base. The real outcome it seems to me is just as likely an increased burden on employers and a disquieting precedent for further expansion.

What will city governments do with an increased Social Security burden? In some respects they will behave as do other employers: absorb some of the cost, pass it backward to employees and pass it forward to consumers. In other words, though there is no tax rate increase for the employees, they will bear some of the employer increase in reduced salaries and benefits. But, public employers differ in some important respects from private employers. Reduced productivity or profit in the case of local government means reduced services. And the consumer is the taxpayer who will be asked to pay more to receive less locally. The effort to reduce the burden of the regressive payroll tax will in part result in shifting it to state and local taxes which are themselves not overly progressive.

Given this admittedly pessimistic analysis of the situation, there is good reason to think that more localities will give serious consideration to withdrawing from the Social Security system. As you know, the Constitutional considerations have prevented the absolute mandating of the payment of the employer tax by state and local governments. In the past, withdrawal from the system has usually been prompted by the employees who think it is to their advantage. More recently, the governments themselves have initiated an increasing number of withdrawals for reasons of local financial stringency, lack of confidence in the Social Security system and conviction that they can, for the same or less money, provide equal or superior benefits to their employees. Since 1959, 372 state and local units containing 52,200 employees have withdrawn. There are notices of termination on file from another 325 units covering more than 500,000 employees. My city is among those that are seriously considering withdrawal from the system, and I would be happy to answer any questions you may have on that subject.

Unless state and local governments can be confident about the future of Social Security, their reasons for considering withdrawal from the system will be multiplied and strengthened. Some of the Administration's proposals are perfectly reasonable—eliminating the unintended escalation of benefits, for example. The general intent is responsible and commendable. However, any significant changes should rest on a solid foundation of common understanding and purpose. Social Security should be an insurance program, based

on employee and employer trust fund contributions with payments proportioned to contributions, providing a floor of protection. At present we are confused; in large part because we do not have a reasonable income support system as a context for Social Security. We should not let that confusion force us into avoiding the difficult questions that should precede hasty changes in the system of financing.

Thank you Mr. Chairman, for your interest in our testimony and for the opportunity to present our views.

NATIONAL MUNICIPAL POLICY—1977 BY THE NATIONAL LEAGUE OF CITIES ON SOCIAL SECURITY

Congress should: "Refrain from interfering in local budgetary decision-making processes by imposing mandatory additional costs on local governments. Specifically we oppose altering the current provisions for entry or withdrawal from the Social Security system."

A. Social Security

The original purpose of the Social Security system enacted in 1935, should be restored through legislative change. It should be returned to an insurance program financed by employer and employee contributions into a trust fund that would provide wage-related benefits to workers as a matter of right. It should be stressed that the program was not designed to provide the bulk of retirement income, but only a "floor of protection" which would be supplemented by the persons' private savings and pensions.

If other resources are not available then supplementary benefits should be available from an income support system.

When an income support system is in place, Social Security benefits should be directly related to contributions. Any person who has been employed and who retires should receive benefits determined on the basis of contributions, regardless of family status. There should be no penalty or reduction in benefits as a result of earnings. There should be no work requirement associated with the program.

STATEMENT OF WILLIAM J. JOSEPH, DIRECTOR, NEW JERSEY DIVISION OF PENSIONS

Financing Social Security

INTRODUCTION

The premise of this paper is that this Congress will shortly be deciding the future of Social Security and perhaps as a result, chart a course for collective security which has had no committed direction in the past. Some may look upon the deficit posture of the Social Security program as due to a series of unforeseen events, which can correct themselves or can be corrected. For our part, we believe the current dilemma was clearly predictable and was formulated at the birth of our social insurance programs. While we make no effort to provide an elaborate historical thesis, we do wish to raise those ideas and those events which have brought us here.

There are a number of issues which have affected the financing of the Social Security program and foremost is the traditional question as to whether Social Security is insurance. We raise it because it is fundamental to the thinking of our fellow citizens—not because it truly reflects upon the Social Security program.

Private insurance is normally based on the equity concept. This doesn't mean that each individual always gets back his money and interest as might be the case if his money were deposited in a savings bank. However, policyholders in the same area of risk will pay the same amount for the same benefit. While the premiums may be the same, the benefits received will vary considerably among the selected groups of presumably identical risks. Using the obvious case of life insurance, someone in the group will die early while others will die after many years of paying premiums.[1]

Life private insurance, social insurance serves as a method of distributing costs, of meeting economic risks of a large number of people over periods of

time appropriate to the particular hazard. Unlike private insurance it is generally compulsory, which ensures normal distribution and should reduce costs. The same advantages are cited for private group insurance.[2] In social insurance the cost falls only partly on the insured, as employers or government or both meet a large part of such cost.[3] In a social insurance program, individual equity must give way to social adequacy.[4] If a program was begun on the basis of individual equity, benefits would be relatively small in the beginning and many years would lapse before the system could provide the benefits for which it was established. Thus, in actual operation social insurance differs widely from the accepted practices of life and other forms of private insurance.[5]

In private insurance there is a contractual right; social insurance makes no such provision. It may be a statutory right but the statute can be changed. Private insurance must be funded if the rights of the policyholders are to be protected. Social insurance may not be funded at all, depending on the nature of the plan. Essentially, social insurance provides for a recognition of a problem confronting society and through the benefit structure and financing mechanism, the economic burden on society is reduced.[6]

One of the apparent differences between social and private insurances deals with the conditions of benefit payments. In private insurance the insured designates the beneficiary and the beneficiary has a right to collect the benefits. In social insurance only specific survivors are considered and only for a period of time when they meet the statutory conditions. For example, a widow's benefit would be terminated if she remarries; children are only eligible up to a certain age, and cannot receive benefits unless they are dependents, etc.

Lord Beveridge defined social insurance as providing cash payments conditioned upon compulsory contributions for the insured person, regardless of his resources at the time of the claim.[7] Since this eliminates need as a prerequisite, the principle of social insurance made an important contribution to western society in widening the scope of the plan. It is not a welfare plan only for the poor, but it covers most workers.[8] Of course, the most important consideration is that it is designed to protect the worker against those recognized catastrophes which plague our industrial society.[9] Usually it is adopted at a time when only government can act since the other resources of assistance have dried up. As such Social Security is not an experiment but it is a true institution of security.[10] However, that doesn't mean that Social Security is insurance. The purchase of private insurance involves the distribution of the possible burden or actual loss upon persons who are willing to pay premiums for that purpose. In social insurance government acts to eliminate the uncertainty and in compulsion forces the payment of the premium.[11] Social Security does not terminate coverage because an individual is unemployed and his participation lapses. As an institution, social insurance contains many of the objectives formerly ascribed to philanthrophy.[12] Yet unlike charity, the means test is eliminated and it then becomes possible to persuade potential beneficiaries that there was nothing wrong in accepting benefits.[13] In fact, in this sense the term "insurance" indeed performed a very useful, social function.[14]

Actually, this longtime argument about whether Social Security is insurance is a relatively academic one because it has been long resolved in law. In 1960 the Supreme Court held in the Nestor case that the system was not insurance. The court said that the covered employee had a noncontractual interest and that this could not be analogized to that of an annuity holder based on contractual premium payments.[15]

The most important consideration is that through the means of social insurance the burden does not fall directly upon the individual, but places it upon groups where it may be more readily borne.[16] Thus, the relative economic position of the last several generations of Americans has been altered by Social Security through its plan of benefits and taxes. The net effect is to raise those in the lowest income brackets.[17] Such efforts are not restricted to Social Security. Through the payment of individual and corporate income taxes, public education has been raising the position of the poor for many decades. Of course, the effect of such benefits and taxes are modified by the differences between individuals, family size, health and the opportunity for direct and indirect benefits. There are many transfers of income in both public

and private areas. Insurance payments, private or social, are certainly a form of transfer, subsidy or charity.[18] The only difference is a matter of degree or purpose.[19]

The United States adopted Social Security on the insurance principle, resting on the theory that this would avoid the appearance of giving people something for nothing. The difficulty is that we have lost sight of the difference between the appearance and the reality.[20] Over the years the media has exaggerated the differences between our social insurance programs and those abroad. The basic ingredients are the same. It is work related. There is no means test. It is contributory. It is compulsory and the rights of participants are defined in the statute.[21] Thus, on the surface the appearance is that workers and their employers pay taxes and, therefore, the benefits are considered to be "earned". They belong to the employee by right and are not bestowed as an act of charity. Yet, this is a mixture of fact and fiction. Certainly the program has become more social and less insurance, chiefly as a result of liberalizations to seal gaps in assistance programs. These measures have proven costly and they may threaten the more basic objectives of the program.[22]

Essentially, Social Security represents a pragmatic way of providing for parents and grandparents.. One of its greater advantages lies in its very financing. Unlike philanthrophy and other voluntary means, social insurance provides an effective method of raising money to finance worthwhile welfare programs.[23] Yet, Americans seem concerned about the actuarial soundness of the program and over the years have long debated as to whether it is really insurance.[24]

ISSUES

There are five specific considerations which run throughout the history of any social insurance program and in terms of Social Security they are as follows:

1. Level of income replacement

The early proponents of social insurance always held that Social Security would end the need for welfare or public assistance programs. The difficulty is that there will always be members of our population with little or no income and who are in need of assistance. Such individuals are women who never worked in covered employment and as housewives are not insured. They include the disabled who could not meet the eligibility requirements. Moreover, under social insurance, benefits are based on past earnings. If the base earnings were inadequate or there was no coverage, the benefits are going to be inadequate or nonexistent. Thus, despite substantial increases in social insurance benefits, there are many Americans who are still poor and who need assistance and who will never meet the test of insurance. An alternative would be to qualify every household even though there is no breadwinner, eliminate the age or disability tests and base benefits on need.[25] Perhaps a government subsidy would not only secure the program in terms of its present deficit, but also provide benefit increases where need can be demonstrated.[26]

Even for those who are covered, cash benefits admittedly provide only a small part of the requirements of many in the population. Such needs include housing, food, education, medical care, etc. We are often told that the problems of the poor in this country stem from these needs and that with the resolution of such problems the war against poverty might be won. But Social Security does not provide for such needs. It provides cash benefits.[27] This is not to say that the other areas have been neglected. With Medicare we had Medicaid in 1965; food stamps is a major on-going program; housing has been subsidized; there are rent supplements; educational opportunities have been opened to the young; a number of free or supported services have been provided, such as day care, legal aid, training, etc.[28] Yet for those who are covered and who are receiving cash benefits, are such benefits adequate?

It appears that Social Security does not permit most of its recipients to raise themselves beyond the poverty level. Most aging beneficiaries depend on the program as their sole or most important means of support. Thus all of the contributions in the past and increasing contributions in the future will not permit millions of beneficiaries to escape poverty.[29] The ideal would be to raise the level of income replacement in order to make it possible for the retired employee to maintain much of the same economic status that he had

during his working life. Most authorities agree that almost all income groups expect that retirement income will be somewhat lower than earlier income levels.[30] The difficulty is that the expectations have been materially decreased as a result of inflation.

In this country we have been able to supplement Social Security for many Americans with private insurance and pension plans. However, we have lost the virtue of thrift. In fact, it would appear that the reliance on social insurance and other collective security measures has weakened the incentive to save. Research has revealed that in the case of middle and low-income families, Social Security is a complete substitute for a substantial rate of saving.[31] While one author may fear that government programs can enslave the individual, we believe that Social Security is here to stay.[32] It has a great burden to sustain. If the future of Social Security depends on adequate financing and this cannot be met by the present tax arrangement, another method must be found.

2. Gaps in coverage

There are many gaps in the Social Security program in this country. We previously noted the plight of housewives—hence the suggestion to provide benefits on the same basis as their domestic employees. Another historical difference between our social insurance programs and those abroad involves most disablements. Aside from the few states where temporary disability benefits are provided, social insurance programs do not now cover accidents or illnesses which are unrelated to work.[34]

In view of all of the liberalizations in benefits over the years, perhaps the reason for the continuing gaps in these programs may be that the potential beneficiaries are not willing to pay the increased contributions, preferring to spend the money on other things.[35] Federal and some other public employees have retained the privileges of their own retirement systems. They may venture into Social Security as a means of supplementing such other benefits. As Social Security qualifications for benefits have never matured, this has led to double dipping. Thus the plan is plagued by the lack of universal coverage on one hand and by selection against the plan on the other. If the program was financed out of general revenues, these gaps would certainly be eliminated and selection minimized.

3. Relationship of benefits and wages

Establishing the Social Security program on the insurance principle required a distinct relationship between covered wages and earned benefits. Like their counterparts in private insurance, the Federal Government was required to establish a very elaborate machinery for the reporting and crediting of wages and service in order to determine if the employee was insured at the time a claim was filed. Yet there are many features of Social Security which are unrelated to wages and the taxes paid. Benefits are heavily weighted in favor of low income earnings and even today, after 40 years of operation, a person can qualify for benefits meeting minimum requirements. Thus while the system was established on an insurance principle, the program itself has a welfare bias.[36] As the program has been altered successfully throughout the years, deemphasizing individual equity and promoting social adequacy, it would seem to us that the extraordinary machinery of Social Security accounting is completely unnecessary.[37] Perhaps this is the price which we Americans must pay for a heritage of individualism. In the past we have always presumed that men with greater skill and higher earnings should be entitled to better benefits than men with less skill and lower earnings. The result, of course, is that benefits are higher to those who are regularly employed in contrast to those who have interrupted employment due to illness, unemployment, etc.[38] It is this very individualism which operates in the area of adjusting benefits due to inflation. If benefits are not increased, then the scale of differences in benefits would narrow between beneficiaries. As Social Security is a wage-related program the effort has been to avoid such narrowing. Yet there is a contradiction, because the same advocates of a wage-related social insurance plan are also opposed to general revenue financing. On that score they argue that as a result of such financing, the government would not be constrained by the resources of a dedicated tax and could raise benefits which might provide more benefits for higher-paid workers than for others.[39]

4. Means test

Social insurance does not abide with the means test and as a result does not meet many of the needs of the covered population. However, the benefits are available even if beneficiaries have some earnings. This is in contrast to welfare where benefits are increasingly denied in those cases where the individual may not have any earnings but can work. If the welfare recipient finds employment, he is singled out as taking jobs away from more entrenched groups of workers and he finds that the assistance he was receiving is drastically altered. Earnings serve to reduce benefits. We are all familiar with the problem of disincentives in the welfare programs where a father with a full-time job must leave his family so that they can continue to be eligible for assistance.[40] However, we insist on continuing this differentiation between social insurance and assistance. One approach to meet the needs of the covered population was the implementation of a Supplemental Security Income program. This was designed to provide an income floor for the aged, blind, and disabled recipients at the lower end of the Social Security benefit schedule. Of course these individuals are not in the mainstream of middle class America for which the Social Security program is designed. This is true of other programs. For example, unemployment insurance is not really intended to help the chronically unemployed, but rather to provide benefits to persons with regular work histories who suffer temporary periods of unemployment.[41]

The pronouncement against a means test could be heralded in periods of prosperity and economic growth, all supportive of an expanding Social Security program. In periods of economic stability or even decline, it might be necessary to look at the means test again. The fiction of Social Security should not be permitted to blind the Congress from the realities of the Social Security burden. This burden will not be altered, whether the additional financing is met through increased dedicated taxes or general revenues.

5. Social adequacy

Two examples of social adequacy in the benefit structure involve disability benefits and the earnings test. When the financing problem was not fully appreciated, Congress was pressed to liberalize benefits. Disability benefits have always been advanced.[42] Like age, disablement forces workers to premature retirement.[43] There was the disability benefit provided by private pension plans which served as a model. The usual waiting period in private plans is for six months before long-term disability benefits are to be paid and the criteria usually is that the individual is permanently and totally disabled to perform his regular job; after review for a period of years, he continues to receive his benefits if he is still disabled and can perform no productive work.

Initially Congress adopted a disability program modeled after this long-term practice in industry. However, in the 1965 Amendments, it modified the definition of disability so that a person could qualify if his impairment could be expected to last at least twelve months.[44] The previous requirement was that the disability was expected to be of long-continued and indefinite duration.[45] Under the program the impairment must be such that the individual is unable to engage in any kind of substantial work which exists in the immediate area in which he lives or whether a job vacancy exists or whether he would be hired if he applied for work.[46] On one hand, therefore, the practice in industry is initially somewhat more generous since the individual is normally permitted benefits if he no longer can perform his regular job. It is only subsequently that he must meet the test of not being able to perform any gainful work. On the other hand, the definition of disability in Social Security determines permanency on the basis of a disablement which would last at least a year, whereas most pension plans require permanent and total disability.[47]

In 1973 Congress approved a reduction in the waiting period from six months to five months. As a result demands were heard throughout the country for similar changes in the waiting period of private plans. Thus Congress which initially followed an industrywide practice, reasonably structured to meet the needs of a social insurance plan, was now becoming a trendsetter. Most companies usually provide temporary disability benefits for a period of the first 26 weeks, so that benefits provided at any time during the 6-month period would constitute a duplication. Another duplication involved Workmen's

Compensation laws in all cases of total disability, temporary or permanent, which would last at least six months. Employees became eligible for a combination of benefits and in some cases were provided with more tax-free income than their net take-home pay when they were working. The reduction in the waiting period was taken despite the 1949 Report of the Ways and Means Committee, which stipulated that the payment of disability benefits should not restrict or interfere with Workmen's Compensation and that there should be safeguards against unwarranted duplication.[48]

Going further one could argue that if the trend continued, Social Security would begin to replace temporary disability benefits now provided in industry. As the work test for disability benefits under Social Security differed from the industry model, the structure of disability benefits for all Americans would change and perhaps not for the better.[49] Another example has been the earnings test. It was not as controversial in the early history of Social Security because the public then appreciated that age 65 was a reasonable retirement age and they hardly could expect to receive benefits while they continued employment. On the other hand, age 65 is no longer as valid in terms of current mortality, and as a result of inflation, the need for adequate income and the desire to maintain the living standard as a retired person comparable to that enjoyed as a worker, has led the public to demand the elimination or modification of the test. With respect to mortality, the Congress actually went the other way. It provided benefits at earlier ages—at age 60 or 62. Thus the aging were presented with inadequate Social Security benefits at earlier ages and with inflation found they had to return to employment in order to maintain themselves. Why was the retirement age lowered?

We appreciate that benefits could be reduced actuarially so that there would be no loss to the system, but it does provide extremely low benefits. Some persons must work while others with benefits based on higher wage levels have no incentive to work. With the increase in mortality the obvious answer would be to increase the retirement age from 65 to something greater. Perhaps the retirement age was decreased in order to remove againg persons from payrolls and replace them with younger contemporaries who were having difficulty finding positions. Our concern, however, is that with the demand to eliminate the earnings test, we again find the aging holding that Social Security benefits should be paid as a right. Certainly if Social Security is a contractural right, then the earnings test and many other features of the program should be modified. Perhaps the aging should be given an incentive to continue work beyond age 65, by providing them with larger benefits. Such an incentive might be superior to any modification of the earnings test.[50]

Actually the earnings test has been already modified to provide benefits at age 72.[51] As a consequence, the aging have been encouraged to seek its further modification. Little is mentioned, however, by our senior citizens about the financing of the program and what such implications would be upon the working population.

We have cited these examples as illustrative of meeting the need for social adequacy in programs established ostensibly on the insurance principle. Actually it was almost at the very beginning of the Social Security program that its requirements were materially altered. Initially Social Security was to provide benefits on the basis of accumulative lifetime earnings, but in 1939 this was changed so that benefits would be computed on average monthly earnings. The change made it possible to immediately provide more adequate benefits. At the same time the program, which began on the basis of providing benefits only for workers, was enlarged to provide additional benefits to dependents and survivors. Thus the benefit and financing requirements were drastically altered as a result of these major changes in the concept of the program.[52] Social Security took substantial steps towards a welfare design rather than one involving individual equities. Larger benefits would be provided to married people rather than to those who were single or without children. More benefits were payable to larger families than to those with a smaller number of dependents. Over the years the scope of family participation has increased, adding dependent husbands as early as 1950, widows age 62 in 1956, children between the ages of 18 and 21 who were fulltime students in 1965, divorced aged wives in 1965, students up to age 22 in 1972, and de-

pendent grandchildren in 1972. Benefit amounts were also increased for the dependent and aged parent and for the surviving children. The aged widow now receives 100 percent of what her former husband would have been eligible to receive.[53] Thus while taxes do not vary by the number of dependents, Social Security benefits do.[54]

In short, benefit schedules have been continuously revised in the direction of emphasizing need at the expense of equity. Minimum benefits have been raised proportionately more than average benefits have been. We believe this was due to the favorable experience of the program, a program which was well received by a population which could support such increasing payments and permit retired as well as active workers to share in the gains from an increasing productivity.[55]

The dire predictions that liberalizations in Social Security would drive out competition from industry did not materialize.[56] Changes in Social Security were paralleled by even greater developments in the private sector. However, the picture was not completely rosy. As the birthrate decreasd and as the economy stagnated, it would be clear that there would be a funding crisis in the future.[57] The inequities of Social Security were not removed but may have been actually increased. The poor were hardest hit. A person who has adequate investment income and a private pension can receive his Social Security payments in full. If someone is poor enough to have to work in order to supplement his Social Security benefits, he loses that income or the benefit. He is not eligible for Medicaid. In fact, he is required to pay the Part B cost of Federal Medicare, which only serves to reduce his Social Security benefits again.[58] The Supplemental Security Income program was designed to decrease the demand for higher minimum benefits.[59] While the pressure has not been relieved because of inflation, the result has worked to the disadvantage of the aged, blind, and disabled persons who do pay Social Security taxes. Many are receiving an SSI check as a supplement to their Social Security benefit. As there is a dollar for dollar reduction in the SSI check, the value of Social Security is limited to someone who is entitled to both, and his income cannot exceed that of an SSI recipient who never paid any taxes.[60].

FINANCIAL STRUCTURE

We have noted some of the influences affecting Social Security. It has long departed from an insurance scheme to one with definite welfare attributes. Yet the financing has remained chiefly aloof from these developments and it is only the current crisis which forces us to reconsider the financing arrangement.

In most pension plans a fund or reserve is established if the cost is met by a level contribution rate. Such level rate presumably has been established sufficient to meet the cost of the program over a period of time. As benefits are likely to rise, the initial contribution will meet the cash needs of the plan and leave a remainder constituting the fund or reserve. The reserve could be larger or smaller depending on the nature of the population, any prior service recognition to those already eligible, the basing of benefits on a greater or lesser degree on the length of time that contributions were made, etc.[61] An alternative to a level contribution is a schedule providing for a lower rate in the earlier years and increases in the future. Normally, the final rate under such a schedule will be higher than the level rate over the same period of time. The size of the reserve will depend on how the schedule fits the cash needs of the plan.

In the extreme, if the schedule started out very low and rose very slowly, no fund might be developed. Under such a program contributions are determined in a manner to equal the estimated benefit payments and is really a form of financing on a pay-as-you-go basis. If there are no benefit commitments, contributions can vary from year to year with benefits proportionate to what was received. Another alternative is to initially have higher contribution rates in early years and lower ones in the future. This is more like the pension plan which is actuarially determined and where prior service credit is awarded. The result is a much larger fund than one in which a level rate may have been used. The larger contribution normally is associated with the payment of an accrued liability for prior service. Once the debt is paid, lower contributions may be possible. ERISA calls for such scheduled financing so

that many plans require increased contributions from employers, which many did not contemplate before such Federal legislation.

The Social Security program has always been financed on a pay-as-you-go basis. The reserves have increased or decreased, but normally cover only about a year of benefit payments and now even that level has decreased. Whenever it appeared that there may be an opportunity for a large accumulation, legislation followed providing new benefits and new taxes. Before new contemplated surpluses were achieved, benefits were again liberalized and the cycle was repeated.[62] Thus, the financial soundness of the Social Security program does not rely on any trust fund, but rather on the government's power of taxation and its ability to collect sufficient taxes. Actually, Social Security has been promoted by the current generation of workers paying the cost of benefits for the prior generation. In the past the economy has expanded so that taxes have risen fast enough in order to permit retired persons to share in the growth and in the gain of productivity. Yet even with this extraordinary growth taxes have been increased many times. As the work force is curtailed in relation to the population of retired persons, the current generation of workers will have to pay an ever increasing tax or the system must be financed in some other manner.[63]

The increase in contribution rate is a particular problem in the case of social insurance systems because the employee's tax may be higher than that which would be required in order to meet the cost of his ultimate benefit. This is why insurance companies can frequently demonstrate to younger people that for the same contribution to Social Security, an annuity policy might result in much larger payments. The comparison does not contain provision for benefits payable to the employee's parents. Thus, one of the disadvantages of having a rate which is increasing is that for those who retired in the early years the contribution was less for the benefits they have been receiving. Even with a level rate, those who retired years ago may receive far more in benefits than the contributions would have purchased on an actuarial basis. The result is windfall benefits. There is nothing remarkable about such windfall, as the same thing happens at the beginning of a private pension plan and the award of prior service credit paid for by the employer rather than the employee. Otherwise inadequate pensions would be provided in the early years of any plan and the plan thus would not really serve its intended purpose.[64] The difficulty arises in answering the moral argument where the worker has given up part of his earnings to support the aging and then holds that he, therefore, has a claim upon future workers.

Is an employee contribution necessary? One author holds that such contributions were never essential for the establishment of social insurance programs.[65] Lloyd George held that contributions were necessary because as long as you have taxes upon a commodity which is consumed, the worker contributes on the basis of what he buys and what he has provided as a result of his labor.[66] Yet the historical background for Social Security taxes was never really a matter of economics. Franklin Roosevelt is quoted as saying that the payroll tax was designed to give the contributors a right to collect their pensions.[67] To the employer the tax may not be another insurance premium, but he adds it to the cost of doing business in the same way as he would add any excise tax.[68]

Social Security has been described as a system of redistributing or transferring income. If the system is financed from general revenue by the proceeds of progressive taxes, it is a transfer from the rich to the poor. The lower income group pays less in taxes and receives more in benefits. When the range of income among the potential beneficiaries is narrower, the money for Social Security comes from the same class who will benefit. Even the aging are supported by contributions of employees who work but who come from their own class. The cost is borne by a population composed of potential beneficiaries with the risks pooled among them.[69]

The financing has had its critics. One writer holds that the trust funds were never in trust for those who paid the taxes. He holds that they consitute nothing more than a "slush fund" enabling Congress to buy votes by promising to give away more than the funds ever held.[70] Certainly, the facts seem to indicate that everytime there was a qustion about the size of the trust fund, it was concluded a smaller balance could be maintained while benefits were

being raised to meet the cost of living. Taxes would rise with the increase in the average wage and since such wages traditionally rose faster than the cost of living, it was expected that there always would be enough money to provide the benefits on a short-term basis. Meanwhile, the taxes would increase automatically. With the decrease in the working population and the downturn in the economy, the cost of living began to rise faster, while the automatic income to the system proportionately diminished.

There are mixed attitudes about Social Security even among the experts. One economist, Paul Samuelson, argues that because of the growth of population and the economic strength of the country, Social Security will continue to provide windfall benefits for future generations so that the benefits will far exceed anything the recipient has paid.[71] A contrasting view from Milton Friedman holds that Social Security requires a highly regressive tax, providing benefits indiscriminately and probably results in a redistribution of wealth from lower to higher income groups![72] Yet everybody would agree that Social Security is an accepted program among the American people and that they have great difficulty in recognizing any of its demerits. However, in more recent times the public has become aware that the Social Security tax is taking a larger part of their income. During the late energy crisis it was noted that there was a 51 percent rise in the cost of gasoline and an 80 percent rise in the cost of heating oil, but that the Social Security tax increased 121 percent.[73]

The fact is that the tax is regressive. It falls most heavily upon low income workers.[74] If the Social Security rates are to be materially increased, the tax can then only become more regressive. If a heavier proportion is placed upon employers, would not the result be to delimit the further growth of private pensions and similar programs and would not employers begin to make every effort to cut back on those plans which have already been adopted? Would not the expectations of millions of Americans whose union representatives bargained for such plans, never be realized? At the same time that Congress is mandating minimum standards for pensions and similar benefit programs, all requiring increases in the cost of such plans, can it contemplate any further employee and employer outlays for Social Security?

The President and the Congress seem eager to adopt a National Health Insurance plan. Even if the ultimate plan is merely to exchange private expenditures for public ones, there must undoubtedly be additional cost if only because of the establishment of minimum cost and quality controls. How is that additional expenditure going to be met if the Social Security tax is also to be increased?

We do not believe that the public is going to be easily reassured as they have been in the past. Whenever taxes have been increased, the Social Security Administration has announced that the benefits are also increasing. Such statements were always misleading because the benefits were certainly not going up as readily or ni any proportion to any tax increase. In fact, most of the increases in tax since 1972 have gone to provide for the deficit in the benefits payable to current beneficiaries. Even at that, the system now faces bankruptcy. While most Americans are aware of the needs of their parents and grandparents, there is increasing unhappiness among workers who are finding great difficulty in making ends meet. They are especially concerned when they see the elderly voting in blocks and being advised to do so by the political leadership. They are concerned when the elderly talk about their rights. They are concerned with the nature of Social Security, not only for the elderly but for themselves. Increasingly they are beginning to challenge the Social Security myth.

Thus we have two issues. The first is the public's misunderstanding of Social Security and perhaps its misrepresentation by the Social Security Administration. Calling it an insurance plan doesn't make it so. In fact, by doing so it may have restricted the opportunity for benefit and eligibility liberalizations.[75] The second issue involves the financing. Perhaps the most honest and revealing statement came during a 1974 interview in which optional enrollment was discussed. The Social Security Commissioner said that such option would impair the benefits promised to those who had retired.[76]

As we view the recommendations of the President, we note that he deals with both of these issues—benefits as well as taxes. While the financing issue may

be the most critical, the future of Social Security can best be determined by looking at both problems. Can we maintain public and private programs, particularly when the public one has been understating its liabilities for years and now must be rescued? As Americans are not going to turn their back upon the aging and the needy in the population, perhaps one solution would be to lower the contribution rate or to freeze it and to make up the difference in the form of a government subsidy. This is true in many social insurance plans abroad where the cost is divided between the government, the employer, and the employee and where social adequacy then is legitimately portrayed in the financing.

GENERAL REVENUE FINANCING

The Committee on Economic Security was not unanimous in the decision to finance the Social Security program on the basis of a dedicated tax. Hopkins proposed that any citizen, on proof of unemployment, old age or ill health, regardless of need, could receive payments from the Government. The cost would be met by general tax revenues. There would be no insurance fund to which the qualifying citizen had paid a premium in the form of a tax.[77] However, the general premise of Social Security financing was to have the cost divided between beneficiaries and their employers while linking benefits to contributions.[78] Of course, the notion of paying for benfits is derived from private insurance. The self financing scheme is the basis not only of Social Security but of many similar programs. In fact, in Workmen's Compensation, the oldest of our social insurance plans, the analogy is so close that in many states employers insure with private companies.[79] However, as Social Security is not a true insurance plan and as it has been modified ever since 1939 in the direction of social adequacy rather than individual equity, is this not therefore the time to recognize what has been apparent for many years?

Years ago the use of general revenues was opposed on the basis that the program did not cover most Americans. That's not true today. It is available to almost all workers. Since coverage is almost universal, excepting for those who have elected not to participate, financing can be borne by all taxpayers and not only those in the work force. In fact on behalf of those not covered by Social Security, general revenues are used to meet their retirement needs. This is the source of monies payable to the Federal Retirement System, to state and local retirement systems of public employees, to the people in the military with their own pension plans, etc. General revenue is used to provide benefits to those not eligible for Social Security or whose Social Security benefits are inadequate.[80]

On this issue of a government subsidy there is a blurring of traditional liberal and conservative sides. Liberals fear subsidy because they believe in the insurance principle, hate the means test and desire to have Social Security continue to be considered as a right. Conservatives believe the insurance principle is a sham, that a means test is warranted, but that Government subsidy would constitute a blank check to liberalizations.[81] The liberal believes that Social Security should not only represent a floor of protection for the average American, but it should be increased as private pension plans do not adequately cover most of the unfortunate or needy in the population. Conservatives would like to have Social Security benefits restricted, to afford the opportunity for supplemental private programs enhancing thrift and reducing the size of the government's commitment. General revenue financing is particularly opposed by the insurance industry because of the fear of run-away benefit changes which will invade its sphere of operation. The insurance industry would prefer to have government continue in those areas which are not profitable, such as welfare, public health, etc.[82] We don't believe that anyone would want to destroy Social Security as a mechanism for meeting the problems of our urban society, where resources must be pooled during the active working careers for payment of benefits when earnings case.

Those of us who support general revenue financing have been attacked on the basis that we favor government subsidy because of the difficulty of increasing payroll taxes. Yet payroll taxes have increased from 1 percent of $3,000 to nearly 6 percent of a wage level which is appropriate to most middle class Americans, and where increasing the wage level to include all wages would not materially increase contributions sufficiently to meet the short-term deficit of

the program. In the past there have always been arguments against government subsidy on the grounds that this would raise benefits without making the public aware of the increasing cost.[83] Yet benefits have been increased and the public is fully aware of the larger outlay required of Social Security. In fact, in many cases it represents a larger outlay than the income tax the taxpayer is required to pay. Those who fear government subsidy hold that it would weaken the cost control elements of the program. Yet benefits have been increased without much cost consideration even though the financing is met by direct payroll taxes. We feel that the Congress will act responsibly in the area of benefits regardless of the source of income available to the Social Security program.

ADMINISTRATION'S PROPOSALS

Included are (1) Employer contributions on the basis of the total payroll; (2) employee contributions on a slightly higher wage base; (3) additional increases in the tax rate in 1985 and 1990; (4) higher tax rates for self-employed; (5) general revenue financing for the next five years if unemployment is over 6 percent; (6) decoupling of the system so that benefits to a future retiree do not reflect CPI increases over the working career, but continue to reflect national wage increases; and (7) requiring relatives to meet a test of dependency on the spouse in order to qualify for dependent or survivor benefits.

The Administration's recommendations are to meet the short-term and long-term deficits. Such are reflected in the report issued by the Senate Committee on Finance of June, 1977. It indicates that over the long-term actuarial costs, taxes now provide 10.99 percent of salary while benefits average 19.19 percent of taxable salary, leaving a deficit of 8.20 percent. We understand that these are the median figures supplied by the Social Security Administration. Actually a more optimistic long-range forecast would make the annual cost 14.87 percent of payroll, while a more pessimistic one would make it 27.08 percent. In the short term the estimate is that the OSI program will run out of money before 1983 and that the DI program will be done in 1979. These are estimates supplied by the Social Security Administration and while that organization may have been optimistic in the past, it would seem that these figures reflect a pessimism which was always warranted in a program affecting the fortunes of so many people.

The Administration's proposal regarding decoupling has been long awaited. The double reflection of the rise in the cost of living, in both benefits payable to present beneficiaries as well as those to be paid in the future, is now considered to be a mistake. Admittedly it was an error in the period of substantial inflation. But was it really a mistake? We don't think so. We believe that the Social Security Administration overreached itself in attempting to juggle the benefit structure between individual equity and social adequacy. While minimum benefits would rise as the CPI increases are reflected in the disbursement, the gap between such minimum benefits and those payable to future beneficiaries would narrow. Thus the Social Security Administration really hoped to widen the benefit structure, expecting the major increases in taxes to establish a pattern for meeting the cost of such substantially higher level of benefits. With the increase in taxes, spending in the private sector would level off and Social Security would no longer be just a floor of protection, but become the primary pension plan of all Americans. This expectation was only defeated by inflation and the deteriorating financial support for the program. As decoupling will be followed by wage indexing, the Administration hopes to maintain Social Security benefits as a percentage of the replacement of former salary at about the current level.

The other benefit proposal of the Administration involves establishing a condition for dependency. This largely stems from recent Supreme Court decisions holding that husbands and widowers are to be eligible to qualify for benefits on the same basis as wives and widows.[84] The suggestion to require everyone to meet a test of dependency is one which is offered up but which Congress is bound to reject. It is not likely that Congress will make it more difficult for widows to receive benefits, just because the courts have made it easier for widowers to receive them. On the contrary, on the first occasion that a widow or a wife is rejected for benefits the change recommended by the Administration would be immediately reconsidered.

We are therefore left with the five items of financial changes and here is where we believe the Congress has an opportunity to make a vital contribution to the direction in which this country is moving. If we continue to tax and tax, supplemental private sources of income security will surely be eliminated. Increasing the payroll tax makes it possible only for the wealthy to continue to save; increasing the wage base prevents the middle class from saving. The poor cannot save because their Social Security taxes exceed anything else that they are required to pay for governmental services. Increasing taxes will also continue the Social Security myth in which the aging believe, that upon retirement, they will receive a benefit based on their tax contributions and those of their employer. Yet the very taxes that are specified in the Administration's proposals, more honestly presented than in the past, convey that these are intended to ensure the benefit payments to those who are already retired, and to meet the short-term deficits.

The suggestion to increase employer contributions would fall most grievously upon small businesses and state and local governments participating in the program. The large employers would merely pass on the cost of the tax in the product sold to consumers, fueling the fires of inflation. Perhaps the Administration believes that it can jawbone large employers from passing the additional cost on to the consumer.

In the case of public employment, with which we have some expertise, the tax would work as a reverse revenue sharing operation. More revenue would be required so that state and local governments could afford to pay the tax. While there is no immediate increases contemplated for employees, there are small bites which are to be taken in the future. In the Secretary's statement,[85] he indicates that by taxing employers and not employees, revenues are raised without raising benefit levels. Thus Mr. Califano continues to be wedded to the same benefit-wage relationship which has resulted in poverty for so many Social Security recipients. Not content at that, he goes on to note while this involves a substantial increase to employers, the increase is less than what they would pay under a more conventional approach in which both taxes and wages were raised. We don't believe that argument is going to encourage employers to support the program. The Secretary must know that the economy is not in such a favorable position that increased taxes and wage levels could be advanced at this time; otherwise the traditional approach would have been followed.

Which brings us to the proposal of general revenue financing. As the Secretary indicates, such financing was considered at the very beginning of the plan and was recommended on several occasions. Congress even passed legislation permitting the use of such general revenues to meet any Social Security deficit. Billions of dollars are already coming from general tax sources to provide minimum benefits payable to certain beneficiaries and to pay for the cost of Part B coverage under Federal Medicare. If we fault the Administration's proposal, it is only because it takes a middle position. We believe it is too timid in the area of general revenue financing and that any consideration of tax increases paid by employers and employees should be shelved and permanently so. The tax is already at a level which makes it an economic disincentive for the economy. It is a regressive tax and as such bears most heavily upon the poor. If it cannot be eliminated, then certainly it should be frozen. We suggest that the employee's share of the tax should be eliminated at the bottom level of the economic order in the form of a tax rebate. The deficit in Social Security doesn't really exist unless the American people are not prepared to pay for their parents and grandparents. We are confident that they are prepared to do so and they should do so on the basis of progressive taxation, wherever possible.

After all, Social Security is only one other program among many that the Federal government is pursuing on behalf of its citizens and should take its place in the proper budgeting of Federal expenditures. It is certainly as critical as defense expenditures or the cost of education, public health, etc., and the benefit level should be fully evaluated in terms of the resources that the country is prepared to allocate to all Federal programs. Congress has never really had to choose between Soial Security benefits and other needs. General revenue financing of Social Security will mandate that. Inflation will not be fueled by general revenue financing any more than it is by increases

in the tax. We hope that the Administration can deliver on its promise to balance the budget and to end the annual deficits. If it does so, it cannot ignore the financing of Social Security. Certainly general revenue financing would be a great accomplishment in assuring the financial stability of the program; the tax hasn't done it and it won't.

STATE AND LOCAL GOVERNMENT EXPENDITURES

May we conclude by citing the implications of these proposals on state and local governments. We can speak authoritatively about the effect in New Jersey and perhaps we can make some national estimates.

State and local governments have two problems:

1. After 25 years of operation in which the state has assumed the responsibility for its reports and those of participating local governments, the Federal Government is about to issue regulations which would require more frequent deposits of Social Security monies. The regulations over the years have required the states to file reports and pay contributions within 45 days after the end of the calendar quarter. The proposed regulations may require the states to transmit monies monthly or even more frequently. The result would be to increase costs significantly in the first year; costs would continue in subsequent years as the state and local governments would lose the present use of such monies and therefore the earnings thereon.

2. In addition we are confronted with the contemplated increase in employer costs as contained in the Administration's proposals.

In the first year the cost of monthly deposits, to the State of New Jersey, on behalf of state employees and members of the Teachers' Fund for which the state pays the employer's tax, would aggregate $29.9 million. Local governments would have to add $20.1 million. The total would be $50 million more in 1978 than the New Jersey government would otherwise have to pay. Secondly, the employer tax on higher salaries would increase the state's liability by an additional $17.6 million. Local government employers would have their costs increased by $13.2 million. Finally, there would be an additional loss of interest income on monies advanced and this would total $4.9 million in the first year for all governments. The state and local governments in New Jersey would be confronted with a more than one-third increase in cost.

In projecting cost on a nationwide basis, we believe that the most conservative factor would be 25 so that all of the cost figures noted above as appropriate to New Jersey could be multiplied by 25

This would be the minimum increase in cost to State and local governments whose public employees are covered under Social Security. Such minimum increase would raise the cost of Social Security to state and local governments throughout the country by $1.4 billion.

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Statement of the Alliance of American Insurers

The Alliance of American Insurers is a major national association of property and casualty insurance companies. Member companies of the Alliance provide workers' compensation, automobile, homeowners and other property and casualty coverage in all fifty states and the District of Columbia. Our

companies are concerned over the financial problems in the Social Security System. While we believe that they may have been averted through the application of sound actuarial principles in program operations, we recognize that they are urgent and demand immediate solution.

The administration's solutions

The Social Security system is in serious financial difficulties. For the short run, the Congress must devise ways to augment the Disability Insurance Reserves and Old Age and Survivors Insurance reserves which, according to present estimates will run out in 1979 for the Disability Fund, and in 1983 for OASI. For the long run, the Congress must develop the means to maintain those funds at levels which will assure that future retirees and the disabled will receive those benefits to which they are entitled by virtue of their contributions and the contributions of their employers.

The Administration has proposed an eight point program to resolve both the short and long run problems. We believe that certain elements in the Administration's program will have favorable impact. Separating the procedures for granting cost of living increases to present retirees from methods for calculating benefits for future retirees, for example, should reduce long term deficits. We favor this element of the Administration's proposal.

We have noted, however, that as a part of its solution to the immediate problem, the Administration would transfer funds from general revenues to the Social Security Trust Funds. The transfer would equal the funds lost by the system when the unemployment rate exceeds six percent.

General Revenue Funding

We are unalterably opposed to the subsidization of the Social Security system through the general fund. While the proposal is limited to the years 1975 to 1978 when unemployment is expected to drop below six percent, we believe that the process lays the groundwork for other injections of general revenue into the system. We feel that general revenues should not be utilized in Social Security funding, because the process could lead to system overexpansion. Social Security needs to be confined to its basic design objectives, it should not become a welfare program.

The injection of general revenues into social security funding would conceal the true costs of the program. Thus, the process could create pressures for benefit enrichment. Under the present system, participants are aware of the costs because they are an easily identifiable deduction from their paychecks. Since increases in benefits would be reflected in larger deductions pressures are created which tend to check benefit expansion. Subsidization out of general revenue transfers some part of the cost to the income tax base where it is lost to the participant's awareness among the many other programs financed by the federal government. In this case, although he is still paying the costs through the income-tax route, he perceives the increased benefits as a greater return on his Social Security dollar.

We feel that pressures for richer benefits would increase with the injection of general revenues into the social security system, and strongly urge that the administration proposal for short term funding through general revenues be rejected.

Financing social security deficits out of general revenues has yet another undesirable aspect. General revenues are derived from income tax, and their outgo is governed by the federal budget. Congress and the Administration are trying to achieve a balance between income and outgo in the next few years in order to provide some stability in the economy. The addition of yet another demand on general revenues could cause significant delays in the attainment of this objective.

The Administration's proposal for financing the Social Security deficit has other implications which need to be explored. High rates of unemployment not only endanger the social security program, but also increase the deficits in the general fund. The Administration proposal would add to the staggering deficit in the general fund which is contributory to the economic uncertainty underlying the unemployment problem, by the transfer to the Social Security Trust Funds. Thus, the proposal could further aggravate the economic uncertainty which lessens business desires to expand.

Unequal Tax Treatment of Employers

Under the existing Social Security financing plan employers and employees pay an equal tax on the first $16,500 of the employees earnings. The figure would rise to $23,500 under current law. The Administration has proposed that these limitations on the employer tax burden be eliminated in steps over the next three years so that by 1981 employers will be taxed on total payroll.

We feel that this change in the financing plan is undesirable. While it would infuse needed additional revenue into the Social Security Trust Funds, it would also violate long established precedent. Since the very beginning of the program, the costs of social security have been equally shared by both employer and employees because the proedure is fair and appropriate for all parties involved. The Administration proposal destroys this joint-sharing by placing an added burden on employers. We believe this is inequitable, and is not in the best interests of the public.

Conclusion

The Alliance is concerned over the financial problems in the Social Security system. While we would agree on the urgent need for problem solution, we are concerned that elements in the Administration's proposal may intensify rather than solve the problems over the long run.

The Alliance believes that the Social Security system needs to be confined to its basic objective—a floor of protection for covered individuals. We are opposed to the infusion of general revenue dollars into the system. We believe that this would increase pressures for altering the system into a welfare program.

BURRELL & REID, P.A.,
South Portland, Maine, May 20, 1977.

Re President's Social Security Tax Plan.

Hon. WILLIAM HATHAWAY,
Federal Building,
Portland, Maine.

DEAR SENATOR HATHAWAY: The purpose of this memorandum is to voice our opposition to the above. Our firm is of the strong opinion that the President's proposal for funding the above plan will create additional inflation. Employers who would have to pay F.I.C.A. taxes on all wages would most certainly pass this added burden on to their customers. Government must recognize the fact that the people can't expect to receive a benefit without a corresponding cost associated with the benefit.

The Government should address its' current problems with the Social Security plan as a business would do under similar circumstances. Senator Goldwater got into trouble during his bid for the Presidency because he proposed scrapping the entire plan. Perhaps we should be looking for alternative means of providing retirement and disability protection to the American public. One alternative would be the rough proposal outlined below:

(1) Discontinue the F.I.C.A. contribution requirement at the end of 1979.

(2) Effective January 1, 1980, require all employers to contribute at least 10 percent annually of a employees wage up to $20,000 to a combined employee retirement/disability plan to be carried with private insurers in lieu of social security taxes.

(3) In conjunction with (2) above require employee contributions of 5 percent on the same wage base and exclude these contributions from the employees taxable income.

(4) Continue retirement plans to those covered under the plan at January 1, 1980 and for those 50 years or older who have paid Social Security taxes for at least 120 quarters of the prior 35 years.

(5) Reduce the benefits to be paid to the above to what they would have received from a comparable insurance annuity for the amounts they and their employers paid into the fund.

(6) Reinsure the benefits to be paid in (4) and (5) above with private insurance companies.

(7) The American public "bite the bullet" for the costs of the continued benefit through increased income taxes. The deficiency in funding reserves would be amortized over approximately a 30–year period.

(8) Merge the retirement/disability plans for State & Federal employees (including military) with that of the private sector as outlined above.

The benefits of the above plan would be as follows:

(1) Increased efficiencies through private placement of the plan.

(2) The "dead horse" Social Security plan would be done away with.

(3) Since many employers now provide for comparable pension plans, the overall costs to the American economy of implementing the mandatory coverage would be substantially less than the 10 percent employer contribution requirement.

(4) The people would have more voice in designing their individual retirement/disability plans.

(5) The Government's administration costs for the plan would be much less than under the Social Security System (The Regulatory Agencies established to administer E.R.I.S.A. could administer the new plan).

(6) An individual's benefit would more fairly equate to their contribution than the current system.

We realize our alternative is not complete in detail and supporting data. Its purpose is to provide a framework for an example of the type of alternative plan that could be implemented. It would require a big sales job on the behalf of the Government to the public.

However, the point that has to be emphasized to the American public is that somewhere along the line the piper has to be paid.

We shall appreciate your consideration of our viewpoint.

Sincerely,

Stephen A. Reid.
John S. Burrell.

KF 26 .F566 1977

United States. Congress.
Senate. Committee on

President's statement on
principles of welfare